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"THE EEC AND SOME CHALLENGES TO IT"
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IAI/RIIA JOINT CONFERENCE

28-29 June 1979

The EEC and some challenges to it

I The first direct election to the European Parliament

A discussion on the European election campaigns and results and the implications was introduced by Keith Kyle of Chatham House and by Professor Cesare Merlini, Director of the Istituto Affari Internazionali.

Keith Kyle referred initially to the two major differences as he saw them between the cases of the UK and Italy. The first was the very low turnout in Britain which he attributed in part to the fact that the British remained unpersuaded that the Treaty of Rome had abolished the distinction between foreign and domestic issues for all time and as a result failed on the whole to identify themselves with the Community, and in part to the fact that very few of the candidates at the election were well-known political personalities. One second major difference was between the electoral systems used for the elections, the first-past-the-post system having distorted the result so that 60 of the 81 seats had been won by Conservatives, only 17 by Labour and the Liberals with 12½% of the popular vote had failed to win a single seat.

A further major reason for the low poll, in Mr Kyle's view, had been the duality of outlook affecting both major parties which had led their campaigns to come across to the public in a muffled manner. In the case of the Conservative Party, whose leader during the preceding national election campaign had placed her main emphasis on conviction politics and especially on the cutting back of public expenditure, he felt that candidates had been inhibited from advocating increased expenditure in the European Community. In the case of the Labour Party, which on general grounds one might have expected to prepare a far more interventionist programme (advocating, for example, the redistribution of resources throughout the Community, restrictions on transnational companies and measures to guarantee the right to work), a large part of the Party was in fact

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opposed to membership of the European Community and, while we remained in, to any extention of its existing powers. Some Labour candidates had been committed opponents of the Community and some not, but most of the latter, in order to persuade their Labour supporters to vote in the election, had not been particularly enthusiastic to proclaim the European message. As for the reasons which influenced this section of opinion in the Labour Party there was the argument that membership of the Community could, by its restrictions on British sovereignty, prevent the introduction of a full-blooded Socialist programme in the event of a Labour election victory under real Socialist leadership. It was also the case that the Treaty of Rome, interpreted as a treaty rather than as a constitution, predominantly assumed a laissez faire, capitalist economy.

Another factor referred to by the speaker was a general disquiet in Britain endorsed by all parties about the Common Agricultural Policy, the one aspect of the European Community of which the public at large tended to be aware, and also its consequences for the balance of contributions to the European budget.

Professor Merlini referred initially to the fact that in Italy, although national elections had been held only a week before the European elections, there had been very little decline in turnout - from around 88 per cent to around 86 per cent. He felt that the turnout in the European elections had been so high because both Europe and elections were popular in Italy. All parties, with a very few exceptions on the extreme left, had campaigned on pro-European Community platforms.

Professor Merlini took the view that the European election campaign in all the Community countries had in fact been dominated by national issues. This had been predicted and, with the exception of the Liberals, European groups or federations of parties had had little influence on individual national parties' campaigns. With the exception of Britain, Professor Merlini did not believe the general turnout was as bad as had been described. Also with the exception of Britain, he felt that the composition of the new European Parliament reflected fairly correctly the distribution of political orientations in the Community. There was a movement to the right, but this was slight and did not indicate a marked trend towards conservative views.

Taking the examples of the British Labour Party and of the Gaullists, the speaker argued that those parties which campaigned for the European

Parliament with a programme of obstacles to further integration had been defeated, their supporters on the whole, having failed to vote. This was important, firstly because it illustrated an indirect reaction on the part of the people, and secondly because it affected the distribution of seats and the commitment of European Parliament members.

Members of the Parliament would be linked to three different kinds of loyalty: a) loyalty to an ideology b) national loyalty and c) loyalty to the European party group: they would join together to improve the role of the European Parliament and the Community itself vis a vis the nation states. Those who had campaigned against this kind of view had had very little success, with the exception of the French Communist Party, which was a special case.

Professor Merlini then considered the future role of the European Parliament. The Community's institutions had diverged from Jean Monnet's original plan, the Commission having lost much of its weight with the role of government shifted from the Commission to the Council of Ministers. It seemed that the Parliament would be the balancing institution to the Council of Ministers. In the treaties, its role was rather ambiguous, with the Commission envisaged as the government body and the Council as the legislature. It now seemed that the Commission was cast in the ambiguous role. Professor Merlini ended by outlining what he saw as the three important steps in the future of the European Parliament:

1 The problem of the budget, its size and structure, in which the Parliament had a definite part to play according to the treaties.

2 The European Parliament's possible future influence in the appointing of members of the Commission and its President.

3 The fact that the Parliament was supposed to establish a new electoral law for all member countries for the next European elections.

The discussion was opened by a British contributor who disagreed with some of the reasons for the low poll in Britain quoted by Keith Kyle. He referred first of all to the very low level of understanding of the nature of the written constitution Britain now had for the first time and to the shock experienced by many people in Britain on realizing that laws could become applicable in the UK without having been debated in the Westminster Parliament. There were, he felt, other reasons than those already mentioned for differential abstention on the part of Labour voters: in Britain many people who would have voted for a Labour Party candidate felt that the Treaty was not very relevant to the problems they faced. There was a feeling that the whole structure of the Treaty might be appropriate in a period of economic growth but not to one of recession and that the institutions lacked mechanisms adapted to interventionist socialist planning. The traditional interventionalist aspect of the Labour Party had never been reflected in the drafting of the Treaty of Rome. It was therefore natural that the Labour Party should put forward a programme for fundamental reform of the Treaty. With reference to Professor Merlini's analysis, he suggested a fourth point to be considered for the future: the need after the accession of Greece and the likely accession of Spain and Portugal for a re-analysis and a renegotiation of the treaties. He thought it likely that the British Labour Party delegation to the Parliament, together with some of their socialist colleagues, would have a special contribution to make on the question of which institutions should be reformed in order to encourage the Community to be a vehicle of planning in a period of recession.

An Italian participant while agreeing with the previous speaker's point about the need for more planning mechanisms during a period of recession, argued that effective measures of this kind would of necessity mean that the Community would have to impinge to a far greater extent than at present on national sovereignty, which would presumably be unacceptable to the Labour Party.

A British Conservative returning to the low turnout at the elections in Britain suggested a number of other reasons for this. The first of these was a widespread lack of understanding about the purpose of elections: people felt they had already voted for the Community in the referendum and did not appreciate the need for a further vote in this issue. Other factors were, he felt, the fact that party workers were exhausted after the general and local elections and therefore the campaign was less efficient than usual; the weather on polling day; and the shortage of petrol in many rural areas. He also felt that because many of the candidates were not experienced politicians they had failed to project themselves to their very large electorates. He did not believe that the electoral system had affected the turnout, arguing that the Liberal vote had in fact turned out although the chances of winning seats had seemed slight. There had been a combination of several factors at work.

The Chairman at this point referred to the passive nature of the electorate in Britain, low turnout being a normal feature of local elections, especially in the cities. Unlike in Italy, the British did not expect to vote very often or to understand much about the issues when they did.

Discussion then turned to the likely developments within the European Parliament which had just been elected. One of the Italian participants argued that the main political activity within the European Parliament during the next few months would be the attempt to find an institutional and political connection between national consensus, which in many member countries was well-established, and a kind of European consensus which was still in its infancy: to establish on which issues there was a national consensus in every European state to transfer competence to the European level.

Another contributor stated that although she had been in favour of direct elections, she doubted whether this would actually produce European-minded action in the Parliament. Directly elected members, she felt, would be more likely to give greater voice to purely sectional interests than the nominated members. They would be subject to many local pressures and it seemed unlikely that this would lead, in the early years at least, to any great excess of Europeanism. The large number of farmers in the British delegation, for example, seemed likely to lead to a disproportionately large voice for one particular interest.

Referring back to the point made about likely re-negotiation of the treaties linked to the second enlargement of the Community, Professor Merlini disagreed. There was an institutional problem facing the Community and this had led to the appointment of the "three wise men" who were to report by October 1979. Professor Merlini expected their proposals to relate rather to the question of how to <u>apply</u> the treaties rather than to that of how to change them. Most governments felt that if the treaties were changed things would become worse rather than better. Thus he thought that the spirit of the <u>acquis communautaire</u> would probably survive. He also expected the Community to state the principle that the admission of new members could not on each occasion involve re-negotiation of the treaties. He was not necessarily very happy about this, as he agreed that the problem of reforming the institutions existed, the problem of the separation of the of the institutions in practice as compared with the theory of the treaties, which led to a number of contradictions. But since there was no consensus on reform of the institutions, this was a situation which would have to be accepted.

Further discussion followed on the role that sectional interests were likely to play in the European Parliament. British farmer members it was thought might well find themselves taking a defensive view of the CAP in conflict with their own government, by representing neither the UK interest nor the Community interest but rather the farming interest.

An Italian participant argued that before considering the strategies of the present European Parliament it was important to realize that its members needed to solve as a matter of urgency the problem of their political role both in the national and the European context. This involved three things: 1) their relations with their respective national political parties 2) their relations with their respective European party federations, if and where they existed, or with informal party alliances 3) the attempt to redefine the role of parliamentary groups. In terms of relations with the national political parties, he thought that a large proportion of the newly elected members had no direct contact with their respective political parties or with parliamentary life at home. This problem would increase as some of the dual mandate members would resign for various resaons. European MPs would therefore tend to feel rather isolated from their national political life and uncertain of the role they had to play in the national framework. In Italy new members of the European Parliament had received an offer from the Foreign Ministry of help in organising their activity in the European Parliament. This kind of generous offer could lead to a de facto forming of a kind of national delegation. Another example was Giscard d'Estaing's suggestion of a kind of inter-parliamentary French group in the European Parliament. Thus there were some forces which were trying to transform the European Parliament into a kind of European diplomatic parliament. This tendency could lead to a degeneration of European political life.

It was the task of the party groups in the European Parliament to try to spread the European spirit inside the national parties, giving the European MPs a clear and specific role in respect of their national political life. They would also be a point of reference to European party federations.

A British participant who began by stating that he did not himself feel emotionally committed to Europe returned to the earlier point about sectional interests. It was clear, he said, that industrial lobbies, for example, had become extremely powerful in Europe and one must worry that the European Parliament, given that it was a rather amorphous body, might be subject to exploitation by such pressure groups. Consumer interests on the other hand were not well represented. He had noticed that, even though trade unions were well represented, they were increasingly turning to the OECD for action on the question of multinationals rather than to the Community.

Another Italian participant emphasised the fact that the European Parliament at present had very little actual power; at the same time there was no evidence of any great drive in Europe at present towards political unity and enlargement would further dilute the political meaning of the Community. It seemed to him, therefore, probable that the European Parliament would fail to create a political consensus. He wondered whether there existed within the elected members a potential political leadership. If not it seemed that the Parliament was doomed.

One speaker felt the whole discussion so far had been based on the assumption that we were about to live in a comfortable world. This would not be the case during the next decade; there would be the recession of unemployment and inflation, which had been forseen for some time, plus the technological revolution of silicon chips, plus the energy crisis and a number of other problems. This led him to question an earlier assumption on the part of Professor Merlini that the accession of new members could not lead to a major reform of the Treaty and to ask whether the present Treaty provided for the possibility of international action to deal with the major problems we were facing. There were at the moment an enormous number of options which were excluded by the Treaty, and that the pressure for its transformation would confront the Parliament and other institutions very clearly in the course of the next decade.

Keith Kyle agreed with the previous speaker about the serious problems which had to be discussed and felt that the European Parliament was the right forum for such discussion . The problem was that those who advocated the discussion of these questions tended to be the very people who sought to prevent the European institutions growing in power so as to deal with them. There were, he argued, three factors which would lead to a review of the treaties: 1) enlargement and especially the accession of Spain 2) the fact that the limit would shortly be reached on the Community's 'own resources' and 3) if the freeze were rigorously maintained on agricultural prices there would be increasing pressure from farming interests in Europe for changes in the CAP.

Another speaker took issue with the description of the Treaty of Rome as a wholly free market instrument. It was in the case of the customs union, but in the case of shipbuilding, steel, energy, for example, there was a great deal of scope for planning if this was what was wanted. It was just that the British Labour Party wanted the planning to take place on a national rather than a European basis. In France, on the other hand, there were many people who were ready to work for planning on a European basis. The Labour Party claimed that the European Community had a free market ethos but had never tried seriously to test this assumption.

An Italian speaker suggested that schizophrenia on the question of free market v. planning did not exist only in the Labour Party but was in the nature of things. Jean Monnet, who had contributed more than anyone else to the setting up of the EEC, had been the inventor of the French Plan. Any modern economy was of necessity running along two different tracks at the same time: market forces and planning were not necessarily in contradiction with each other. He ended the discussion with his own speculations about the future of the European Parliament: its powerlessness might, he felt, be more important than its powers. We were entering a period of greater confusion and fraught with greater changes than we had known in the last 20 or 30 years. Institutions were important but one natural reaction to such situations was the rise of movements. The European Parliament could become a meeting point for sectoral interests or, with the necessary leadership, could become the stage for a movement of some kind.

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IAI/RIIA JOINT CONFERENCE

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The EEC and some challenges to it

II Convergence and divergence in the European Community

The afternoon session of the conference considered two papers on economic divergence and the European Community which were introduced briefly by their authors.

Dr Hodges stressed his view that the issue of economic divergence was being used as a cover to avoid debate on the long term future of the Community. The founding fathers of the Community had not foreseen that it would be a problem, or had thought that any divergence would be temporary and limited and could be avoided by the co-ordination of policies. The Treaty of Rome did not provide a sufficient basis for overcoming divergence as it left the major instruments of macro-economic policy in the hands of the member states. The early years of the Community had been a period of growth rather than of redistribution; however, the issue of redistribution had become more important in a period of low economic growth. His view was that Community policies to correct divergences would be only marginally effective, although it was possible that specific sectoral policies, such as that on steel, would have a convergent effect. The divergence debate needed in fact to define the ultimate objectives of the Community and to clarify what kind of convergence among member states was desirable. Any long term changes, such as those needed to achieve convergence in living standards, would require a political consensus among the Nine which is not yet present.

Dr Hu in his introduction raised four main points:

1) the difficulty of defining what was meant by divergence and convergence

2) three issues concerning the Community as a whole and British relations with it:

a) the budget. Britain and Italy, although among the less prosperous members of the Community, nevertheless ranked as the greatest net losers in terms of net transfers to the budget. The question of equity was leading to demands for political justice.

b) agriculture. There was a conflict between food importers and exporters over the issue of prices, and between France and West Germany over MCAs.

c) energy. Britain as an oil producer had different interests from the other eight members, and there were also different national positions over the search for energy supplies, as shown recently over the question of controlling the Rotterdam oil spot market.

3) the difference in the positions of Italy and Britain. Referring to page 13 of his paper, he considered that Britain's longstanding economic condition reflected the political and social structure, whose stability and ability to resist change produced these economic problems. Italy's problems had arisen more recently.

4) the question of co-operation between Italy and Britain. This was affected by their divergent interests, by the fact that they represented only 30% of the economic weight of the Community, and by the need to attract the smaller member countries to their side, although the smaller countries were more dependent on the Community and the French-West German bloc.

The discussion began by considering the meaning of the terms convergence and divergence. Convergence is commonly used to mean i) convergence of policies ii) convergence of economic performance and iii) convergence of economic interests. Convergence of policies was felt to be particularly difficult because of the distinctive social and political structures within member states and their different assumptions about handling economic and social problems. In addition to the meanings listed above, the term convergence was also used when in fact the debate was really about equity, and in particular equity of contributions to the budget. It was suggested that the Community as currently established could have very little effect on convergence as between member states, especially with regard to convergence of economic performance. Examples were given to show that existing sectoral policies in the Community still tended to transfer resources to the richer countries; for instance Corsica received 34 ecu per capita from the Regional Fund, whereas the figure for Calabria was 19 ecu per capita. The Regional Fund had in fact very little net effect on the net financial contributions of Britain and Italy to the Community. The policy's ability to assist economic convergence between member states was also questioned, given that governments' national regional policies had had only a minimal effect on divergence within countries, for example between the north and the south in Italy and between Scotland and the south-east in Britain.

The conference then considered the question of convergence of economic performance. Although some contributors felt that convergence of economic performance was an unrealistic objective in the foreseeable future, it was shown that there had been some overall convergence of performance in the Community in the early 1970s, and in fact there had been more convergence between states than within them. It was felt that the debate on convergence/divergence was not actually intrinsic to the Community, which had been fairly successful in dealing with this inthe past, but had arisen now because of recent external shocks to the Community, namely the collapse of the Bretton Woods international financial system, the rising prices of raw materials and the changing structure of the international economy in general. Not unnaturally, different countries had reacted to these shocks in different ways, and although the stronger countries were able to react more effectively in the short term this did not necessarily signify that divergence was only a problem for the weaker countries. The issue of divergence thus became a question of finding a common and valid response to the external challenge. The Community should be able to act effectively on this, considering that basically the Community was defined in relation to the outside world, with its members adopting a common external position. However, attention was drawn to the inter-relationship between external and internal policies, for instance in textiles and shipbuilding, and to the Community's lack of success in dealing with these problems so far.

Participants then debated Italian and British attitudes to the Community. For historical reasons there was in Italy a national consensus in favour of the Community; the country had no chance of solving energy or raw materials problems outside the EEC and therefore the commitment to Europe also included the willingness to accept the costs of Community membership. In Britain, however, there was no such national consensus and there were still suggestions that Britain could survive in isolation or should work towards a framework of co-operation which would include the USA and Japan as well as West Europe. The different commitments to Europe had led to different national responses to the European Monetary System. The Italian decision to join the EMS had been influenced by three major factors: i) Italy was willing to accept some costs arising from this political step to better integration; ii) there were basic differences between the EMS proposal and its 1971 predecessor, with the EMS involving governments as well as central banks. It was felt that France and West Germany would be more committed politically to the EMS and would show more solidarity with the weaker countries. Entry to the system therefore became a gamble which Italy could afford; and iii) Italy welcomed the external financial discipline involved which would aid its own plan to reduce inflation. The Italian trade unions had also been in favour of EMS because it was seen as a contribution to convergence and the government had also accepted the need for measures to counteract the negative aspects of the system. Italy considered that membership of the EMS had enabled the country to avoid the speculation against weaker currencies which was inevitable in the present oil crisis. Britain, in a similar economic position, had chosen not to join the system. In further discussion of the EMS it was felt that the weakness of the system was that it did not take into account the external world and had no means of applying pressure on the source of currency instability, the US dollar. On the other hand it was argued that the system could have a future role as part of new global monetary arrangements. The view that both EMS and earlier proposals for EMU were doomed to failure was expressed with some force. It was suggested that the proposals for EMU and for the EMS misunderstood the political situation in that they involved member states giving up a degree of national sovereignty and would also seek to impose constraints upon recalcitrant members. The system was bound to fail sooner or later given the different economic performance and level of inflation in countries and member states' need to defend their own national interest.

The conference returned to consideration of the British attitude to the Community, debating whether the British commitment was primarily economic or political. It was suggested that the economic case for EEC membership had not been overriding and that in fact political reasons were paramount. In the British view, the issue of convergence was actually one of equality of contribution. Britain was ready to accept some cost as a result of membership, but it was stressed that there was a real grievance over the size of the net contribution to the budget. Given the country's economic position it would in fact be more appropriate for Britain to receive a net benefit. British defence of national interests was not seen as unreasonable; indeed all the major EEC countries usually acted and voted for their own divergent national interests. It was accepted that the budget issue was primarily political and of symbolic importance and also that any solution could create problems for the other member states as a lower British contribution would mean that others would have to increase their contributions to the Community budget. The British government, it was contended, needed to improve the formulation of its objectives and pay attention to the creation of 'links of confidence' with other governments. More understanding for the British position could also be achieved if Britain were to show that in different circumstances it would play a more active and positive role in the Community; at present the legitimate

British grievance over the budget dominated the country's reaction to every issue. Britain should formulate an ambitious programme of advance for Europe, with which the country could identify, and which could involve wideranging proposals for political co-operation, industrial policies and Community institutions.

Participants disagreed as to whether economic divergence within the Community would affect its political future; disparities within member states, and also within the USA, had not led to the break-up of these units. However, it was pointed out that the unredressed grievances felt by a substantial section of the population of the USA had led to the Civil War; and there was also an economic element in the political demands of Scotland and Quebec. The federal tax system in the USA, it was felt, ensured some redistribution of resources in favour of the poorer regions, and the suggestion was made that even this level of redistribution within the Community would greatly further the development of a common sense of commitment to the EEC. This common sense of commitment was one of the features which distinguished integration from interdependence. Interdependence was defined as the interpenetration of the economic structures of various countries, whereas integration was a conscious guided process designed to harmonise conditions among the countries involved. The argument over convergence and divergence became important if the Community were seeking integration as this involved harmonisation and a positive attitude to active policies. Convergence of policies was seen as an essential element in creating a body which differed philosophically from other international organisations. The conference agreed that the EEC was philosophically and qualitatively different from other organisations such as the IMF and the OECD, although there was no consensus on the reasons for this difference.

The conference noted that the possibilities for Italian-British co-operation were influenced by their different attitudes and policies towards the Community. Italy had supported British membership and had hoped to form with Britain a counterweight to the Franco-German axis. As this had not happened, Italy would now hope to seek allies among the prospective members in order to form a southern group. It was generally agreed that there was in fact no possibility of an Italian-British axis on the French-West German model, as the political ingredient of the latter was not present. However there had been instances of joint action by Italian and British representatives at Community meetings and it was felt that a working, tactical alliance between ministers and officials on issues of common interest, such as the budget, would be to the advantage of both countries. It was also suggested that the Franco-German alliance was not as solid and effective as it appeared, and that this was one of the reasons for the Community's failure to develop adequate responses to the external challenges it faced.

Responding to the discussion Dr Hu again raised the question of integration and interdependence and whether divergence matters to the Community. He felt that the weaker countries could not in fact hold the others to ransom, partly because they would not wish to jeopardise later action affecting their own vital interests, and partly because the stronger countries could always bypass existing institutions. He illustrated this with reference to such successful European ventures as the Airbus, Eurodif and Urenco, which were outside the framework of Community institutions. In his opinion the pessimistic views expressed about the future of the EMS had some validity if the system were seen only as an exchange rate mechanism; however the intended creation of the ecu and the pooling of reserves were probably more important. Finally Dr Hu responded to the question of the philosophy underlying the Community. The creation of a community involved common goals and the transfer of alliegance, not just the pursuit of common interests, and he queried whether these conditions were yet satisfied in the case of the EEC.

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The EEC and some challenges to it

III Newly Industrialising Countries and the EEC

Introducing his paper, Louis Turner pointed to three areas which he thought the conference might consider:

1) What were the structural differences between the British and Italian economies which might lead to different perceptions of and reactions to the increase in exports from newly industrialising countries? In particular was the UK more apprehensive of competition because it was losing jobs in manufacturing industry to a greater extent than Italy where manufacturing industry was still growing? Or did the high percentage of Italian employment in the clothing sector - about 22 per cent - affect perceptions? Did the fact that Italian state-owned companies were generally more flexible than their British counterparts make adjustment easier? Were Italian trade unions more committed to free trade than their British equivalents?

2) The advocates of free trade felt that UK governments had not so far pursued very successful policies of industrial adjustment, continuing to 'back losers' by supporting loss-making enterprises in sectors such as steel and shipbuilding. Was Italian government policy more successful?

3) Were there differences between British and Italian trade policies towards developing countries? In particular, what was the Italian position on the European Community's attempts, led by Britain and France, to secure permission from the developing countries to introduce a selective safeguards code in GATT? Did Italy have a special relationship with a particular set of NICs - with Yugoslavia or Spain for example?

Perceptions of implications of exports from NICs

Italian participants elaborated views on the growth of exports from NICs and the need for industrial adjustment by the advanced industrial countries. So far there was little direct concern in Italy on job displacement resulting from NIC competition. Italy was still a net exporter in many industries and the impact of competition from new producers in third markets had not been studied in any detail. It was suggested that the public sector, rather than being flexible in its approach to adjustment, had so far had a negative impact. If anything, private enterprise had transferred its problems to the public sector; a number of private companies had managed to adjust successfully by selling out their plants in Italy to state holding companies, retaining their brand name and establishing manufacturing plants in developing countries. Clothing companies had, for example, set up in Romania, where they could manufacture on specification without the need to invest capital. However, state holding companies were now beginning to realize that this policy could not be pursued indefinitely. IRI was affected by NIC competition because of the concentration on sectors in which the company was involved such as steel and ship-building, and reorganisation of these sectors had started. However in one area of collaboration with NICs private companies were ahead: that of collaboration in transmitting technical expertise. It was true that IRI was selling steel technology to Brazil; but private firms were ahead in establishing plants overseas.

Trade union attitudes

The attitudes of Italian trade unions had changed since the early 1970s, as the rate of structural change from an agricultural to an industrial economy had slowed down. The unions were less ready than before to accept the need for industrial and regional mobility, and were increasingly resistant to industrial adjustment. A 'new corporatism' was developing in which management and unions were working together to preserve industries and jobs. Business could use the political influence of the unions in order to secure new investment for sectors or plants in difficulty. So unions' attitudes were contradictory; in some respects they could be more resistant to change than their British counterparts; yet on the other hand, they perceived the need for adjustment and had given some indications that they would accept change if the process was planned and negotiated. Inter-firm mobility would be accepted, for example, if there was an obvious demand for labour.

Relations with groups of NICs

The general point was made by Italian participants that the NICs were by no means a homogenous group. Italy would favour measures taken at the international level which would encourage the expansion of industries in developing countries with large internal markets, e.g. India or Brazil, rather than those which produced for export, e.g. Hong Kong or South Korea. As far as special interests in particular

NICs was concerned, Italy certainly considered she had a special relationship with southern Europe, in particular with Turkey, Greece, Spain and Portugal. There were obvious political motives in developing close economic ties with these countries - preserving stability in the Mediterranean being a prime consideration. Similar considerations also applied to developing ties with Eastern Europe. However, it was asked, how would Europe cope with adjustment within its borders after enlargement of the Community; and how would Yugoslavia and Turkey fit in? Italian participants suggested in reply that there had been little discussion of these specific issues in the context of international economic policy. In principle Italy favoured enlargement but was aware of the potential problems, especially in agriculture. There were demands for reform of the common agricultural policy to take account of this. It was suggested that enlargement need not necessarily be a burden for the Community. The experience of the development of the Italian economy inside the EC showed that membership not only stimulated trade but also provided an opportunity for other members to influence the social context, bringing wages (and social benefits) up to the level of the rest of the Community. Outside the EC Spain, Greece and Portugal would continue as NICs with low-wage economies, producing cheap labour-intensive goods; but inside, they would no longer be low-wage producers and would therefore offer less intense competition to other member states.

In contrast to southern Europe, the small East Asian countries were seen as 'wild' exporters whose products Italy felt less able to accommodate. One problem was the failure to develop any regional co-operation in South East Asia. Until recently Japan had been a disruptive influence in the international economy with no stabilising effect in South East Asia. As long as there was little or no regional co-operation in South East Asia these countries would continue to put pressure on the international market. We should therefore, it was argued, treat Japan as a special case, taking ruthless measures if necessary to force her to take more responsibility for fostering regional integration. It was pointed out in reply that there were important reasons for NICs in South East Asia producing for export. As with Japan, they needed to earn foreign exchange to pay for increasingly costly imports of energy and other raw materials from other developing countries. Nor was it the case that Japan did not trade with other East Asian countries. There was more trade between Japan and the adjacent NICs, a British participant observed, than between the member states of the EC and South European NICs. While the area of an East Asian co-prosperity sphere led by Japan might be politically hard for e.g. ASEAN members to accept at present, there were signs that it might be developed in the future.

Regional co-operation had also been slow to develop in Latin America and prospects were if anything less hopeful than in the past. Brazil was absorbed by the problem of the growing gap between the two-thirds of the population providing cheap labour and the one third of highly-paid, well-organised labour.

An Italian participant pointed out the problems associated with industrial development in developing countries, wondering whether the advanced countries should be encouraging their integration into the international trading system. Delayed industrial development could create imbalances, as in Brazil, with the advanced sector remaining specialised and attracting more resources. The problems of unbalanced patterns of development had been clearly demonstrated in Iran, where social demands had been encouraged, demands which could not be satisfied. Developments in Iran had had far reaching effects in our own economies, and it was in our own interests to examine how we could assist Third World countries towards more balanced development of the whole economy. Advice through international organisations was one possibility. Trade and adjustment policies therefore had considerable impact on the international economy, beyond the immediate effect on employment in specific sectors.

Louis Turner agreed on the significance of this argument and pointed out that some NICs were well aware of the pitfalls of unbalanced development. The distribution of wealth in Korea and Taiwan was relatively balanced; Mexico was not proceeding flat out with the development of its oil resources in order to avoid the tensions which had arisen in Iran. Any policy adopted by the advanced industrial countries, whether we encouraged them to develop industries and kept our markets open for their goods, or whether we protected our industries against their competition, would have implications for their economic development. He argued that protectionist policies could have a very detrimental impact on the overall development of NICs. For example, South Korea had built up manufacturing of colour TV sets on the grounds that it had a comparative advantage over the US. But once its industry had been established the US had blocked its exports and Korean capacity was now lying idle, with obvious adverse effects on employment. Similarly the African countries which were beginning to develop clothing industries on a small scale were concerned that the advanced industrial countries wanted to include them in the Multi-Fibre Agreement as soon as they became significant exporters, thereby harming their chances of development. (He added that the Chatham House project was not looking specifically at these exporters nor at the possibilities for regional co-operation in West Africa, but was concentrating on more advanced exporters.)

Another British participant agreed that it was extremely hard - if possible at all - for the AICs to indicate patterns of economic development to Third World countries. Commenting generally on our perception of the implications of the NICs development, Louis Turner argued that it was hard to make out an economic case that we were harmed overall by increasing trade with them. OECD statistics showed that the o overall balance of trade between a number of NICs and the OECD countries was favourable to the latter, although it should be remembered that Japan was included in the OECD and this distorted the picture to some extent. There were opportunities for us to export machinery, machine tools, aircraft, for example. The East Asian NICs had learnt from the example of Japan that they would only receive fair treatment for their exports if they liberalised their own import policies, which Japan had been slow to do. There was a tendency to blame the penetration of UK markets by NIC imports for the troubles experienced by many sectors of UK industry. But our balance of trade with the NICs was still favourable, and our industry's problems were based to a greater extent on competition from 'the North' - e.g. other Community countries such as Germany - or on our failure to keep up with technological changes or respond to different demand patterns.

The AICs' response

Nevertheless, the OECD statistics showed that the impact of NIC exports differed among the advanced industrial countries (AICs). Britain and Frnace were harder hit than West Germany or the Netherlands, for example, who had succeeded in moving up-market, concentrating on producing higher-technology and more sophisticated goods. These differences in impact raised some awkward problems for a co-ordinated response from the AICs. The second part of the session concentrated on this question, in particular on the role the European Community could play, both in relations with the NICs and in the industrial adjustment policies of its members.

European Community-NIC relations

Was there scope in the Community's Mediterranean policy or through the Euro-Arab Dialogue for influencing the NICs' thinking about the direction and scope of industrialisation? It was argued that the European Community should above all encourage the development of regional integration, in spite of the fact that most attempts at regional co-operation by developing countries had failed so far. Economic co-operation between the European Community and Eastern Europe was vital; detente must be carried out in economic as well as political terms. We should consider the relationship between North-South and East-West problems. Along with the German SPD, many in Italy considered that Eastern Europe must be made aware that it was part of the North. So far, East European countries had behaved as 'southern' - raising large loans, exporting aggressively. There was a need for a common EC position on this. It was argued by a British participant that the present UK policy on dumping by Comecon countries was not satisfactory. While failing to act against Russian dumped goods, we were at the same time extending highly favourable export credit terms, enabling the USSR to modernise and penetrate our markets further.

Relations between the Community and the Mediterranean non-entrant countries were a major concern of the Italian government. The IAI was embarking on a research project to study the question. An Italian participant was optimistic that positive co-operation could be developed; the Community could offer technical assistance and industrial co-operation, for instance. Here, too, the European Community should endeavour to promote regional integration; in the past, political differences between Arab states - which Europe had done nothing to discourage - had been an obstacle.

Adjustment policies

An Italian participant argued that there was no reason for the AICs to continue to keep up development of manufacturing industry in all sectors. The East Asian NICs were concentrating on producing for export in some sectors and continuing to import goods in others. We should attempt to specialise more in response to this. This was one conclusion of the recent IAI report on Italy and the New International Economic Order. As far as the UK was concerned, a British participant argued that not too much weight should be attached to the problem of the Lancashire textile industry, which had tended to attract attention on account of political pressures exerted by MPs with marginal seats. But it remained to be seen how far the new government would allow its free market philosophy to extend to allowing market solutions to the adjustment problem and to international trade. One question requiring attention was dumping; it was not yet clear whether present anti-dumping legislation (now transferred to the European Community) was effective enough. As far as moving up-market was concerned, some Ministers had argued in favour of a high exchange rate for sterling so that the UK could emulate Germany in producing higher quality goods. But it was questionable whether our economy was open to such developments. It was not entirely clear what sectors the UK could move into apart from relying to an even greater extent on invisible exports. We had failed so far to cut down shipbuilding capacity.

Trade policy was not only variable. The point had been made (e.g. by Lawrence Franko) that the NIC drive to export had in part been prompted by difficulties in raising finance on the international market in 1975 and 1976. At present Eurodollar markets were geared to short- and medium-term lending and the only development projects which looked feasible were export-orientated. We should attempt to develop larger and more diversified financial facilities that could cater for long-term development needs. Present policies of keeping reform of the international monetary system separate from development were short-sighted and politically unwise.

The role of the European Community

What role could the European Community play in adjustment? It was argued that, because consumers in advanced industrial countries were badly organised on a national basis, the most vocal groups were lobbies calling for protection of particular industries or local plants - an unholy alliance of labour and management to promote protectionism. This suggested that there should be more action on adjustment at Community level, where there was no direct nexus between EC policy-making organs and geographical pressure groups as there was in national parliaments. But whereas there was a Community position on trade policy, industrial policy was lacking. The Common Commercial Policy was therefore being used as a substitute and was generally being used to promote structural maintenance rather than adaptation. Governments did not need to accept the idea of positive adjustment so long as they knew they could exert pressure at Council of Ministers level to maintain protectionist trade agreements such as the MFA. Yet the EC level was the most appropriate for developing industrial adaptation policies. Partly on account of the ideological bent of some of its members - the German Government's dislike of restricting imports without industrial adaptation was one example - it might be possible for sufficient pressure to promote positive adaptation to be exerted at Community level. The incentive would be a threat not to renew restrictive trade agreements. Furthermore the burden of adjustment might be shared more effectively among member states in the context of a Community-wide industrial policy. It was doubtful whether we could go on much longer without such a policy while maintaining a Common Commercial Policy.

The conference explored the problems surrounding the development of a Community industrial policy. It was suggested that it would be difficult to agree on international trade and adjustment policies without involving the US, and this pointed to the use of the OECD as a forum for working out such policies. But, it was pointed out, the OECD might be a useful forum for debate, but did not possess the Community's powers of compelling governments to act. Another problem, which might also be overcome by using the wider forum of the OECD, was the deep philosophical split among the Community's member states - particularly between France and to some extent Italy, with dirigiste traditions, and Germany with a more liberal philosophy. Finance, industry and government interacted in different ways in different member states and this provided further barriers to economic co-operation. There was considerable overlap between the public and private sector; and a further problem of distinguishing between direct and indirect government subsidies. There might therefore be a role for the Community in drawing up rules governing the use of subsidies, both to industries internally and export subsidies.

The case for a strong Community industrial policy was put by an Italian participant. It could provide the stimulus to structural change and innovation which was so lacking in Italy and the UK. Italy had insufficient research and development capacity to maintain the rate of technological improvements in the petrochemical, stell or automobile sectors, whose rate of development was consequently slowing down. A Common industrial policy could help to overcome the political constraints on adjustment. Instruments did exist under the Treaty of Rome; Article 92 on state aids provided scope for developing rules on subsidies; and there were opportunities in government procurement policies at national and Community level. We needed to work out together some incentives for greater labour mobility.

Others remained sceptical about the possibility of developing an effective full-scale industrial policy. Member states accepted Community level action in crisis sectors but were reluctant to move to other sectors. The minimalist attitude wanted common goals without common instruments; the maximalists called for common goals and common instruments, but this implied a degree of institutional reform for which, it was argued, we were not yet ready. Non-tariff barriers to trade were so deeply rooted and governments could intervene in so many diverse ways to subsidise activity; the Italian government, for example, did so by extending credit to bankrupt businesses or by taking over businesses in trouble. How could rules possibly be enforced at Community level? It was argued that the best hope would be for the Community to establish policies which were additional to national ones, along the lines proposed by John Pinder in his arguments for the 'extranational Community'. For example, the Community could establish a scheme for unemployment benefits, alongside national schemes, with the aim of encouraging mobility. Or a common subsidy system could be adopted in the high-priority area of energy, again additional to national systems. It was important that these additional instruments should not involve rigid rules preventing governments from introducing national schemes and pursuing national goals; this was the trouble with the CAP, where some governments had ended up imposing their national goals on other member states. They should instead be flexible instruments, not necessarily involving all member states in any particular area. The fact that economic philosophies differed was no barrier to this type of development, so long as diversity was accepted. After all, considerable differences in economic practice or regulations could exist among regions within a single member state.

Finally, it was asked, what was the role of the oil-producing countries in the petrochemical industry. Was it a special problem because of the producers' leverage over the West, or did it pose fewer problems of labour displacement on account of the industry's capital-intensive nature? Japan was developing refining capacity in South Esat Asia so as to reduce the threat to supplies implicit in moving refining to the producing countries. What should Europe's policy be? Louis Turner considered this question in his concluding remarks. He agreed that the oil producers had a distinctive role. It was logical for petrochemical industries to move to oil-producing countries to take advantage of the supply of cheap natural gas. However, Saudi Arabia was applying extremely rigorous standards to the establishment of new projects and would only go ahead with schemes that made sense in economic terms. But since petrochemicals was a high-technology industry, the AICs were bound to feel that they could not afford to let it relocate entirely. For the moment, on account of North Sea supplies, Northern Europe did not face the choice between the decision of whether or not to allow refining to relocate. But for Southern Europe there would be a choice, between investing in refining locally and re-locating in the Middle East.

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Economic Divergence and European Integration

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It is now generally agreed by observers of the European Community that it has reached a critical phase in its development and that over the next two or three years some important choices will have to be made on the essential purpose of the Community. Three different paths of development can be seen, involving either continued integration through the development of more Community instruments and policies, or maintenance of a 'steady state' based on the existing _acquis communautaire_ achieved under the framework initially established by the Treaty of Rome, or evolution into a much looser grouping based on cooperation in limited spheres of common interest. The Member States of the Community have, in varying degrees, accepted that the Community needs to be re-evaluated in the light of its further enlargement to twelve members and the continuing turbulence in the world economy; at this month's meeting of the European Council in Strasbourg the heads of government are due to consider what role the Community should play in contributing to greater convergence of economic performance and reducing the disparities between the economies of Member States through its common policies. The recent publication by the Commission of figures for net contributions by Member States to the EEC budget, which show that Britain and Italy as two of the poorest community countries are by far the largest net contributors while Denmark (the most prosperous) is the largest net recipient,(1) have added fuel to the debate over the role the Community should play in promoting economic convergence.

This issue of economic divergence also underlies the deliberations of the 'Three Wise Men' who are currently preparing their report on possible adjustments to the machinery and procedures of Community institutions 'required for the proper operation of the Communities... and for progress toward European union',(2) for submission to the European Council in October this year. Although it would be pointless to speculate on what gifts the wise men will bring to the summit, it does seem important to re-examine some of the basic assumptions of the architects of the Treaty of Rome which established the EEC and has guided its development for over two decades. In the current debate over the future role of the Community, the fundamental question is whether Britain or any other community member is justified in assuming that the EEC - as it was conceived and as it has evolved - has any role to play in overcoming divergences in economic structures, policies and performance between the Member States.

To put things more bluntly, can we agree that the EEC's objective is to create a community of equals, or does the Treaty of Rome's call for 'a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relationsbetween the States'(3) imply not equality but the preservation of diversity in an era of economic interdependence? If the latter is the case, then it is clear that the expectation of some British policy-makers that the Community can be used to overcome economic disparities through the transfer of resources is unrealistic and unjustified, and that if the

Community is to have a part to play in the promotion of economic convergence it can only be through the emergence of a new political consensus which departs from the economic and political assumptions of the EEC Treaty.

The Founding Fathers and their Working Assumptions

If we go back to the formative years of the Community, we find that neither the Spaak Report (which was accepted as the basis for the relance européenne by the six Foreign Ministers in Venice on 30 May 1956 after less than two hours of discussion) nor the Treaties which closely followed it, ever precisely defined what was meant by a 'Common Market', except that all agreed that it included a customs union whose implementation was programmed fairly closely. What lay between that minimal state of negative integration and the distant peak of 'ever closer union' was, in the phrase used by one analyst, 'a good deal of mist and dead ground'.(4)

Nevertheless, the Spaak Report and the Treaty of Rome can tell us a good deal about the working assumptions of the founding fathers as they sought to achieve 'common bases for development' and the 'progressive fusion of markets' in Europe. The Spaak Report stressed growth rather than equity: 'In an expanding economy, this division of labour manifests itself less by the displacement of existing production than by an even more rapid development, in the common interest, of more economic forms of production'.(5) Although the Report was prepared to justify in certain temporary situations state aids, regional assistance, and derogations from the Treaty, it did not expect long-term disruptions to emerge from the creation of a customs union and stressed that the creation of a large market under conditions of free competition would benefit all members.

Indeed, the Spaak Report made it clear that national economic policies might well undermine the advantages to be derived from a common market: 'The role of the state in the modern economy is also evident in the divergences which each can bring about in the levels of economic activity or prices. This cardinal point underlines both the risk and the opportunity involved in the creation of a common market.'(6) The opportunity was to coordinate economic policies in order to overcome balance of payments problems which hindered continued expansion, and therefore the common market could only come about if a transitional period made possible changes in decision-making to establish common rules whose implementation would be overseen by Community institutions. One of the essential aims of the institutions would be 'to obtain a convergence of efforts to maintain monetary stability, a high rate of employment and a high level of economic activity.'(7)

When we examine the Treaty of Rome, we find that its provisions for the creation of the institutions of the EEC drew upon ECSC experience, but that the balance of power between the Council of Ministers, representing member-states, and the Commission, representing the 'Community interest' was rather different from the division of power between the Council and High Authority in the Coal and Steel Community. In part this was a reflection of the more open-ended nature of the EEC in comparison with the limited functions of ECSC, but also it was the product of an unwillingness to grant supranational powers if they could be manipulated and extended as Monnet and his colleagues in the High Authority had done. The Treaty's emphasis on the virtues of the free market led it to give only a secondary role to activities and policies designed to correct imbalances or divergences, which it regarded as being largely temporary and exceptional, and could be minimised by careful co-ordination of national economic policies.

The Treaty provided a detailed timetable for the initial stages of the common market through provisions for the abolition of internal tariffs and the erection of a common external tariff, and it established principles and guidelines for a common agricultural policy. On other matters it was much less specific, and its liberal free market philosophy tended to regard measures to correct divergences or imbalances arising from the creation of the customs union as either unnecessary or temporary deviations from the norm. Although the Preamble to the Treaty affirmed that the signatory states were 'anxious to strengthen the unit of their economies and to ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions', there were few attempts in the early years of the EEC to develop any real co-ordination of economic policy, let alone the establishment of common policies controlled and financed at the Community level. The dismantling of internal tariffs and the establishment of the common external tariff, or 'negative integration' as it is often called, did not 'spill over' through the 'expansive logic of sector integration' (as Ernst Haas theorised at the time)[8] into 'positive' integration through the development of Community policies.

Only in agriculture and commercial policy can the Community claim to have developed substantial common policies, while in most other areas the Community plays a subsidiary and supplementary role. The result of the 'Luxembourg compromise' of 1966, resolving the constitutional crisis caused by a six month French boycott of Community institutions, was to eliminate majority voting in the Council of Ministers on issues considered by any state to be vital. This meant that the establishment of new common policies (even in transport, for example, where the Treaty had already provided for a common policy) or the restructuring of existing policies (such as the CAP) was made much more difficult than the founding fathers had envisaged, and the crisis marked a decisive shift in the balance of power toward the Council of Ministers and away from the Commission. The reassertion of the power of the member states (underlined by the Merger Treaty of 1965 which gave the Committee of Permanent Representatives an official role in the Community's system) did not, however, undermine the 'acquis communautaire' - an indication that integration did not depend upon perpetual progress to safeguard its achievements, even in the case of the obvious costs and shortcomings of the CAP. Indeed, the elaborate system of MCA's and 'green currencies' devised to deal with the breakdown of the Bretton Woods international monetary system provides further support for the argument that the 'acquis communautaire' has demonstrated its durability in the face of economic turbulence.

<u>The emergence of the convergence issue</u>

The establishment of the common market has been accompanied by a significant increase in intra-Community trade and hence economic interdependence, so that fluctuations in the level of economic activity have tended to be transmitted between member states more rapidly than before, resulting in diminished effectiveness for national monetary and fiscal policies in regulating the level of domestic economic activity. Although the Council of Ministers recognised the need to strengthen economic policy coordination as long ago as 1964, when the Medium-Term Economic Policy Committee was established to draw up a series of five-year plans, the programmes emanating from the Committee were very general and had no great effect upon divergent national economic policies.

As the initial phase of economic integration matured in 1968 with the establishment of a customs union and the full implementation of the CAP, the Community's member-states began to be painfully aware that they had come to the area of mist and dead ground beyond which lay the (mirage?) of European Union - federal, confederal, or other. Instability in the international monetary system (fuelled by America's guns and butter policies, upward movement of raw material prices, and growing militancy of union wage demands), growing doubts over the Atlantic relationship and the implications of US-Soviet détente, and the lack of progress in moving the Community beyond the basic framework provided by the Treaty of Rome all served to emphasise the vulnerability and absence of ambition of the Community. The 1969 Hague Summit opened the door to enlargement of the Community and called for plans for economic and monetary union; a year later the Werner Report's plan for progressive achievement of EMU by 1980[9] emphasised the need for promotion of economic policy convergence as a prerequisite for monetary union, but did not delve into the question of whether convergence in economic performance could be brought about by policy coordination among the Community countries alone, nor the problem of divergence in economic structures which an irreversible monetary union would do nothing to solve and might well aggravate in a common market.

It would not be appropriate here to examine in detail the unhappy history of EMU and the floating membership of the snake, nor the intricacies of the debate between the 'monetarists' and 'economists' which followed the proposals for EMU. Suffice it to say that the demise of the Bretton Woods system, the enlargement of the Community and the changing structure of the international economy (with challenges from Japan, OPEC, Korea etc. to be added to the American défi) all served to underscore the vulnerability of the Community and the failure of the 'acquis communautaire' to bring about spontaneously 'a harmonious development of economic activities, a continuous and balanced expansion', and the rest. The fact was that the Community had achieved its major successes at a time when world trade and capital movements were being progressively liberalised with the enormous economic and political power of the United States being used as both the engine and the stabilising force; the Community had been 'condemned to succeed' in its phase of negative integration because there was nothing to stop it. As it entered the period when positive integration, in the sense of common policies (or at the very least very close coordination of national policies), were needed, the US lost its gravitational pull and the web of interdependence which had been previously created faithfully transmitted the shocks created by the new situation. Although divergent national economic policies had been seen in previous years as an obstacle to further integration, the debate on the Community's regional policy served to underline the failure of the Community to achieve greater convergence by reducing regional imbalances - the Commission's 'Report on the regional problems in the enlarged Community' of May 1973 argued that 'it is clear that rapid progress towards Economic and Monetary Union would be arrested if national economies had not undergone the transformations needed to avoid excessive divergencies between the economies of Member States'.(10)

By the time that the oil crisis and the accompanying recession hit the Community, the initial preoccupation with policy convergence (in the sense of mutually reinforcing national economic policies) - which was itself a substitute for the economic convergence which a decade previously had been expected to flow automatically from the progressive implementation of the customs union - was now supplemented by concern over long-term divergences in the performance of the economies of member states. By 1978, for example, inflation rates varied from less than 3 per cent in Germany to over 12 per cent in Italy, while per capita gross domestic product as a percentage of the Community average ranged (on 1976 figures) from 141 per cent for Denmark to 47 per cent for Ireland. The pattern of income levels within the Community clearly indicates the emergence during the last decade of a two-tier community consisting of France, Germany, Denmark and the Benelux countries on the one hand and a group of low-income countries (Ireland, Italy and the UK) on the other, with the prospect of further enlargement of the Community threatening to increase the degree of economic divergence between member countries.

If one reads statements by Community politicians over the last five years one finds that they fall into two major groups - a group consisting of those who consider that no major progress can be made in developing Community policies until economic divergences in both policy and performance have been overcome (this group also includes some who fear that continuing divergence will lead to disintegration) and a group of those who advocate monetary union as a means of promoting convergence and also of stimulating the development of Community regional and other policies. In fact both groups agree that economic convergence and further European integration go hand in hand, but attempts to overcome the circularity of the debate have not produced any notable result. The Tindemans Report on European Union (December 1975) suggested not a multi-tier but a multi-velocity approach, and on the subject of EMU argued that:

> It is impossible at the present time to submit a credible programme of action if it is deemed absolutely necessary that in every case all stages should be reached by all the States at the same time. The divergence of their social and economic situations is such that, were we to insist on this progress would be impossible and Europe would continue to crumble away.....This does not mean 'Europe à la carte': each country will be bound by the agreement of all as to the final objective to be achieved jointly; it is only the time-scales for achievement which vary.(11)

The political result of a multi-velocity Community was seen by some member-states as the introduction of a political hierarchy, with the fastest members determining the direction and (insofar as excessive lags would be impractical) the overall rate of change. For all the fears of the Balkanization of the Community, the pious wishes for increasing coordination of national economic policies, and the general consensus that 'the implementation of the EMS....must be supported by increased convergence of the economic policies and performances of the Member States' (a quotation from the 'conclusions of the Presidency' issued after the Paris summit in March 1979),[12] the Community remains uncertain about its future and lacks an overall long-term framework, a socio-politico-economic paradigm, into which proposed initiatives can be fitted and their mutual implications assessed. It is for this reason that the EMS debate was such an unproductive parade of special interests, and why the Community's laggard economies have found the quality of Franco-German mercy to be somewhat strained. On December 7 last year Chancellor Schmidt warned of the danger that monetary instability might degenerate the common market, such that 'five more years of monetary upheaval in the Common Market will lead us to a situation in which we are dealing with fictions, not realities.'[13]

The problem with EMS is that, along with the imposition of 'essential disciplines' on national authorities, it will reinforce the tendency of the market to concentrate capital and activity in the more competitive areas of the Community, and will deprive the less favoured nations or areas participating in it of the means to protect themselves against this imbalance in economic activity. When the weaker economies attempted to link EMS with resource transfers and budgetary questions, however, they aroused the suspicion that an open-ended commitment to resource transfers would not only cushion but probably retard economic adaptation. The EMS debate has certainly illustrated the limits of political cohesion with the Community, but it should be remembered that the Community has made some substantial political progress at a time of unprecedented economic turbulence - the establishment of the European Council, the gradual advance in European Political Cooperation, the impending direct elections to the European Parliament, the agreement on further enlargement of the Community. Since all this occurred at a time of increasing divergence in the economic performance of the Community's member-states we must examine the linkage between economic and political integration more carefully and not assume that there is a stable relationship between them.

It would be helpful if we had a theory of interdependence which could enable us to predict the political consequences of economic divergence for the European Community. It is clear that existing theories of integration are in this respect inadequate or obsolete; theories of economic integration deal almost exclusively with market integration and pay little attention to the problems of policy integration, while theories of political integration are concerned almost exclusively with the incremental growth of supranational institutions in an analytical focus which has had no counterpart in reality for over a decade. Both branches of integration theory were, of course, a product of their time, and both reflected the uncertainty and ambiguity of the debate between the liberals and the dirigistes.

The Treaty of Rome itself was a product of this sublimated disagreement on the role of government in the modern economy; it is primarily an instrument of market integration (through the liberalisation of goods and factor movements together with some sectoral policies, notably for agriculture) but with the exception of commercial policy it leaves all the major instruments of macroeconomic policy in the hands of the member-states, and therefore the Community as originally established had no direct role in the task of promoting growth, employment, price stability and balance of payments equilibrium. It is clear now, and was clear in 1958, that there was no agreement to eliminate governmental intervention in the economy (let alone transferring such powers to Community institutions), nor to harmonise economic policies except where they directly affected the operation of the common market. If there was no clear agreement on liberalisation as an overall objective, neither was there a consensus on the need for redistribution in the EEC. The EEC has been characterised as a trade-off between the German desire for a liberalised customs union for industrial goods and the French wish for a supported common market for agricultural produce, but this was about as far as the redistributive aspect of the Treaty of Rome went.

European integration was seen twenty years ago more as an engine of growth than as a means of redistribution: 'integration' promised all things to all men as long as growth was sustained and imbalances in development did not become intolerable. In subsequent years, as a result of the turbulence of the international economic system and the increased interdependence of the advanced economies, concern began to be expressed as to the extent to which the dynamics of growth produced redistributions in favour of the developed centre of the Community at the expense of its peripheral regions (or even countries), while the institutional paralysis and enlargement of the Community inhibited agreement on measures to compensate for this imbalance. The effect of the recessionary climate of the 1970s was to turn the Community from an engine of growth and cooperation into a stake in the struggle of national interests, with no consensus on the future role of the Community or the steps toward it.

Although much lip-service is now paid to the desirability of convergence (both in terms of policy and performance) within the Community, it is difficult to take this seriously in the absence of a more general agreement on the ultimate objectives of the Community which might clarify the sort of convergence which is needed. It is not clear that a formally recognised two-tier Community would promote convergence and it might well introduce an element of political stratification; if convergence is not seen to be necessary, then the need for a two-tier system to cope with divergence would diminish considerably. In essence my argument is that it is impossible to assess the importance of divergence in the absence of some consensus on the long-term objectives of the Community, and that although growing economic interdependence and a less favourable global environment have brought the divergence question to centre stage in the Community, the issue of economic divergence must be subordinated to the issue of the Community's ultimate goals. Neither the framework established by the Treaty of Rome nor the acquis communautaire was intended to deal with divergence and there is a strong suspicion in my mind that economic divergence is being used as a scapegoat for the failure to agree on what path the Community should take. It is by no means clear that economic divergence is the root cause of this political stagnation, and the failure to confront the political 64,000 u.a. question cannot be glossed over by fine words about the desirability of policy coordination (but only where it is painless and cost-free). As John Pinder has noted: 'The illusion that the dilemma of intergovernmentalism or supranationalism can be evaded by coordination of national policies is a dangerous one, because it is bound to be followed by disillusion'.(14)

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Unless some future European Council enjoys a conversion akin to that of St. Paul on the road to Damascus, the divergence issue will remain with us for the foreseeable future. Given the interdependence of the industrialised economies and their differing degrees of vulnerability to changes in the international economic system, the problems of divergence will remain a permanent feature of the Community and will need to be managed rather than eliminated. Divergence cannot be made to disappear at a stroke, and there is some justification for doubting the assumption that economic divergence is in all its manifestations a Bad Thing. If divergence is partly the expression of different social preferences, it might be presumptuous, time-consuming, expensive (and impossible?) to eliminate it, and it could be argued that the major political consequence of economic divergence in the Community should be the abandonment of our tendency to equate integration with homogenisation. If the 'Three Wise Men' can tell us how to maintain political equality in the midst of economic diversity they will have endowed the Community with a priceless gift.

Footnotes

(1) The Economist, 31 March 1979, pp. 37-8.

(2) Bulletin of the European Communities, no. 12 (1978), p. 97.

(3) Article 2.

(4) Richard McAllister 'The EEC Dimension: Intended and Unintended Consequences', in James Cornford (ed.) The Failure of the State, London: Croom Helm, 1975, p. 180.

(5) Comité Intergouvernmental crée par la Conférence de Messine: Rapport des chefs de délégation aux ministres des affaires étrangères. Brussels, April 1956, p.13.

(6) Ibid., p. 17.

(7) Ibid., p. 23.

(8) Ernst Haas The Uniting of Europe, London: Stevens, 1958.

(9) Report to the Council and the Commission on the realisation by stages of 'Economic and Monetary Union in the Community', Supplement to the Bulletin of the European Communities, I, 1970.

(10) COM(73)550, (April 1973), para. 19.

(11) Bulletin of the European Communities, Supplement I-76, pp.20-21.

(12) Agence Europe, No. 2637 (14 March 1979).

(13) Financial Times, 8 December 1978.

(14) John Pinder 'Das extranationale Europe', Integration 1/78, p. 18.

(5)

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IAI/RIIA JOINT CONFERENCE

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Economic Divergence in the EEC - Issues Concerning Italy and the UK

1. As members of the Big Four in the EEC, Italy and the UK share some important characteristics and problems, but until recently, the two countries appear to have adopted divergent policy postures. Whether measured at marked exchange rates or at purchasing-power parity rates, income levels in Italy and the UK are considerably lower than those in Germany and France. Moreover, structural characteristics in the two countries have combined with the mechanisms of the Common Agricultural Policy to lead to a perverse situation whereby both countries are large net contributors to the EEC budget. On top of this, both countries suffer a welfare and economic loss by having to import their food at CAP prices significantly above what they would otherwise have to pay if there were no CAP. In addition to the net budgetary figures which were leaked extensively to the press by the European Commission, there have been attempts to calculate the burdens of higher CAP prices, for example, in an article published recently in the Banca Nazionale de Lavoro Quarterly Review and by the Cambridge Economic Policy Group. Turning now to the monetary and financial spheres, Italy and the UK have displayed some of the highest inflation rates in the EEC in the wake of the 1973 oil crisis, and both countries had to have recourse to international borrowing for their balance of payments.

2. Despite similar problems and a presumption of common interests within the EEC, the two countries have not been able to act in unison in the same way, for example, that the French and Germans have. Thus, the UK appears to have fought much harder on the issue of net budgetary contributions and for a freezing of CAP prices. Meanwhile, Italy has adopted a much lower profile on these issues, and has elected to join the European monetary system, from which the UK has kept a certain distance. For their international borrowings in 1976, the UK has relied mainly on multilateral institutions (the IMF and Central Bank Swap Arrangements), whereas Italy has depended to a greater extent on Community loans and bilateral loans from the Federal Republic. This conference will probably think of other examples of divergent postures by the two countries.

3. What are the major reasons for these divergent postures? Does Italy see greater benefits from its membership of the EEC than the UK which compensate for the obvious budgetary and food price costs? Or is it a question of a greater ideological commitment to the European idea? Was it simply that sterling was too important a currency to be dealt with at the EEC level, or was there greater Community solidarity in the case of Italy than the UK? These are some of the questions that the conference may wish to address.

4. What of the future? How do the two countries view the prospect of either German hegemony or a Franco-German directorate? What should the two countries do?

Yao-Su Hu

Economic Divergence in the EC: a Background Paper

Yao-Su Hu

I. Economic Divergences between Major EEC Countries

Meaningful comparison between an increasing number of countries soon becomes unmanageable, so I have chosen to focus on the four largest: the UK, Italy, France and West Germany (hereinafter referred to as Germany for simplicity). The post-war period can be divided into three sub-periods: (1) the aftermath of the war, which was dominated by problems of shortages and reconstruction; (2) the golden period of growth, which extended from the late 1950s to either the late 1960s or early 1970s; and (3) the period of turbulence in the 1970s, marked by floating exchange rates, commodity and oil price increases, worldwide inflation and recession. Since years prior to 1955 may be considered to be too close to the war, and since 1974 marked the beginning of a severe worldwide recession, I have decided to concentra e on the period 1955 to 1973 in order to ascertain relatively long-term trends, though I shall have a few things to say about the post-1973 period, which may be seen as having exacerbated rather than created the underlying divergences.

A. GDP growth (see Table 1)

Over the 19-year period from 1955 to 1973, the overriding divergence was that between the UK, with an average[(1)] real growth of 2.8 percent per year, and the three, who grew at more than 5 percent per year.

After the war, Italy started at a very low level, with a per capita income of $290. Industrial growth was led by a group of advanced manufacturing companies based in the north such as Fiat, Olivetti and Montecatini. Modernised under the Marshall plan and supplied with cheap labour, these companies were able to produce highly competitive exports in mass-produced, standard-technology, consumer-durable goods for which income elasticity of demand was high. Economic recovery benefitted from the policies of the strong governments of de Gasperi (1945-53). During the 1950s, industrial

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(1) Arithmetic mean of the annual growth rates.

TABLE 1 [illegible]

[illegible]

GDP growth in 1970 prices, percent per annum

	U.K.	Italy	France	Germany
1955	3.2	6.1	5.0	12.0
1956	1.0	4.0	6.8	7.2
1957	3.0	5.7	6.0	5.6
1958	0.6	4.5	2.5	3.5
1959	3.9	6.9	2.5	7.4
1960	4.7	5.6	7.3	8.9
1961	2.7	9.2	5.5	5.1
1962	0.8	6.2	6.7	4.0
1963	4.1	5.4	5.7	3.4
1964	5.8	2.6	6.3	6.8
1965	2.2	3.2	5.9	5.6
1966	1.9	5.8	4.0	2.9
1967	2.5	7.0	4.8	-0.2
1968	3.4	6.3	4.7	7.1
1969	1.1	5.7	7.0	8.2
1970	2.2	5.0	5.9	5.9
1971	2.5	1.6	5.4	2.9
1972	2.6	3.1	5.6	3.4
1973	5.5	6.3	5.6	5.1
1974	0.8	3.4	3.9	0.6
1975	-1.8	-3.5	0.1	-3.2
1976	2.3	5.7	4.6	5.7
1977	0.7	1.7	3.0	2.4
1978				
Arithmetic mean, 1955-73	2.8	5.2	5.4	5.5

Source: OECD *National Accounts of OECD Countries*

IMF *International Financial Statistics* productivity growth, at 5 percent per annum, outstripped industrial wages which grew by 4.1 percent per year,(1) providing for plough-back into expansion and modernisation, and allowing export prices to fall by 23 percent in absolute terms between 1953 and 1962. Italy's exports grew by 10.7 percent per year in 1950-61 and 12.1 percent in 1962-72. Among OECD countries, its record was surpassed only by West Germany and Japan in 1950-61, and over the period 1950-75 as a whole only by Japan. Italy's long steady growth, however, coincided with increasing perceptions of social and political problems. The campaign for higher wages in 1962-63 was followed by a recession in 1964-65, during which GDP growth dropped from an average of 6 percent per year to below 3 percent. By 1966, growth had recovered strongly, but massive strikes broke out in autumn 1969. In 1969, 37 million working days were lost, as compared to 9 million in 1968. Meanwhile, industrial investment had failed to recover from the 1964-65 recession: between 1964 and 1972, gross industrial fixed investment grew in real terms at only 1 percent per year, compared to 9.1 percent for the period 1952-63(2). Over the period 1955 to 1973 as a whole, Italian GDP grew at 5.2 percent per year on average (Table 1). When Italy and Britain are referred to as the 'weak' economies, it should be borne in mind that Italy has demonstrated greater dynamism than the UK and that its problems are different in nature.

During the period 1955-73, French GDP grew at an average of 5.4 percent per annum, slightly higher than Italy (Table 1). By the 1960s France had made a strong recovery from its long period of economic stagnation and decline, which lasted at least from the Great Depression to the liberation (1929-44). Major changes of attitudes, in many ways made possible by defeat in the war and the association of the older, deadbeat generation with the Vichy regime or the Occupation(3), corresponded to France's effective and rapid recovery. French planning, public sector investment, and the establishment of a financial mechanism, centred around the Crédit National and the Caisse des Dépôts, to mobilise savings and channel them to priority investments,(4) contributed to raise the level of industrial investment and influence its composition according to targets defined in the Plans. Over time, the emphasis of the Plans shifted from meeting quantitative targets in basic industries to improving competitiveness in the context of the EEC. Despite the succession of weak governments under the Fourth Republic (1946-58), the existence of cadres from the Grandes Ecoles provided an important element of leadership and continuity in both government and industry, and it was during the Fourth Republic that Planning was instituted and the decision taken to join the EEC. Under De Gaulle, French industry gained in self-confidence, and the French balance of

(1) K. Allen and A. Stevenson, An Introduction to the Italian Economy, New York, 1975.

(2) ibid.

(3) J. Ardagh, The New French Revolution, New York, 1969.

(4) Y.S. Hu, National Attitudes and the Financing of Industry, PEP, 1976.

payments became strong. There are interesting comparisons to be made between French and Italian post-war economic development. In real terms, French GNP increased by 172 percent between 1955 and 1975, while the figure for Italy was 150 percent. Both had major strikes and riots in 1968/9. The influence of the French example on the Italians suggests the coming into existence of a new mechanism for the international transmission of change, this time via ideas, perceptions and moods. The French system has, however, subsequently demonstrated greater resilience and stability than the Italian, partly perhaps because the trade union movement in France is weaker. In 1968, French trade unions were still campaigning for recognition by employers of the right of union officials to carry on union business on the firm's time.

Before and during the war, Germany was already the industrial superpower of Europe. In constant prices, the gross capital stock in industry, which had been damaged by the war, was estimated(1) to have grown by 20 percent between 1935 and 1940 and by another 20 percent between 1940 and 1943, and to have regained its 1940 level by 1949. Many factors, (2) on top of hard work, have contributed to Germany's post-war recovery and sustained growth since then: a brutal monetary reform in 1948, undervaluation of the Mark throughout the 1950s and 1960s, a qualified and disciplined labour force supplemented first by refugees from East Germany then by Gastarbeiter, a high level of savings and investment, a competitive capital goods sector, a flexible industrial banking system(3), an export mystique(4), and the combination of an authoritarian tradition (recently typified by the Berufsverbot) with fear of inflation. Although Germany's GDP growth rates have fluctuated more than those of France or Italy, the fact that over the post-war period as a whole they have not been lower (5.5 percent for 1955 to 1973) has served to maintain, if not reinforce, her relative position.

Britain's relative low rate of economic growth is not only a post-World War II phenomenon. It can be traced back to the beginning of this century or even the later half of the 19th,(5) though the divergence in growth rates of GNP per man-year appears to have been smaller in pre-World War II periods. In the entire period from 1955 to 1973, real growth in the UK exceeded 4 percent a year only four times, in 1960, 1963, 1964 and 1973. However, as long as the level of output per person was higher in the UK (in 1950 it was estimated that GDP per capita in the UK was 20 percent higher than in France, 58 percent than Germany and 125 percent than Italy),

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(1) R. Krengel and E. Baumgart, Die Industrielle Vermögensrechnung des DIW, Duncker und Humboltdt 1970.

(2) Bernard Keizer, Les choix de la RFA, in Economie et Statistique, July 1978. H.C. Wallich, Mainsprings of German Recovery, Yale 1955.

(3) Y.S. Hu, ibid.

(4) M. Kreile, West Germany: the Dynamics of Expansion, in International Organisation, Autumn 1977.

(5) National Institute Economic Review, July 1961: Economic growth: the Last Hundred Years.

higher rates of growth in other countries could be viewed as convergence towards UK levels. The continuation of these divergent growth rates, however, after other countries had overtaken the UK in terms of levels, means increasing divergence in living standards.

The underlying divergences do not appear to have changed with the OPEC oil price increases, world recession and inflation. Although all four countries experienced negative growth rates in 1974 except for France where GDP stood still, recovery since then, in 1975 and in 1976, has been more sluggish in the UK than in the three. In both years the growth rate in the UK was less than half those in the others (Table 1).

B. Labour Productivity(1)

In 1955, labour productivity in the UK was 15 percent higher than in France and Germany and 40 percent higher than in Italy. Labour productivity here refers to gross value added in GDP per person employed, where comparisons of GDP as factor cost are made at purchasing power parity (PPP) exchange rates. As a result of faster growth of labour productivity, France and Germany had overtaken the UK by 1961 and so had Italy by 1973. After 1973, the UK had the lowest level of labour productivity of EEC countries. If official exchange rates had been used for the comparisons, the gap between the UK and other EEC countries would have appeared somewhat greater. In the manufacturing sector taken on its own, the situation has been even more unfavourable to the UK. Not only did France and Germany have higher levels of value-added per man hour in manufacturing than the UK by 1955, but Italy had also reached the UK level by 1968. The situation in 1970 is shown in Table 2. A fact worth noting is the closeness of French and German performance.

TABLE 2

Relative levels of gross value-added (VA) per person employed, 1970

UK = 100

	Gross VA in GDP per person employed(a)		Gross VA in manufacturing per person employed(a)	
	at PPP rates(b)	at OERs(c)	at PPP rates(b)	at OERs(c)
U.K.	100	100	100	100
Italy	97	100	105	111
France	124	138	164	177
Germany	128	148	155	176

Source: D.T. Jones, in National Institute Economic Review, August 1976.

(a) At factor cost.
(b) Converted at purchasing-power parity rates.
(c) Converted at official exchange rates.

(1) This section is based on D.T. Jones, Output, Employment and Labour Productivity in Europe since 1955, in National Institute Economic Review, August 1976.

C. Income Levels

Given the size, structure and growth of total national populations, differences in growth rates and productivity levels are reflected in differences in levels of GDP per capita, or income levels. The International Comparison Project (ICP) sponsored by the United Nations and the World Bank has been comparing income levels at PPP exchange rates or International Dollars. The latest results are shown in Table 3.

TABLE 3

GDP Levels Per Capita, 1970 and 1973

UK = 100

	At PPP rates(a)		At OERs(b)	
	1970	1973	1970	1973
UK	100.0	100.0	100.0	100.0
Italy	77.5	77.7	78.6	80.5
France	115.3	125.6	127.4	152.3
Germany	123.3	127.7	140.3	176.5

Source: I.B. Kravis, A. Heston and P. Summers, International Comparisons of Real Product and Purchasing Power, Johns Hopkins Press 1978.

(a) Purchasing-power parity exchange rates.
(b) Official exchange rates.

The use of PPP rates as compared to OERs reduces the divergences between France and Germany on the one hand, and the UK and Italy on the other, by between one-third and two-thirds, but does not eliminate them. Indeed, between 1970 and 1973 the divergences have continued to increase slightly, so that by 1973 GDP per capita at PPP rates in Germany and France were more than 25 percent higher than in the UK and more than 60 percent higher than in Italy. Table 3 also confirms the closeness of French performance to the German level.

It should perhaps be noted that growth in terms of OERs is not irrelevant even though it may not be matched, to the same extent, by growth at PPP rates. There are terms of trade gains which may not be reflected in statistical index-numbers. Moreover, international transactions (including the purchase of foreign assets and contributions to international bodies) take place at market, not PPP, exchange rates. The greater a country's GDP at actual exchange rates, the greater is its economic and political weight and power. Finally, the weakening of a currency increases the burden of servicing and repaying foreign debts. Between the first quarter of 1970 and November 1978, the trade-weighted effective exchange rate has declined by 50 percent for Italy and 40 percent for the UK, compared to a decline of 13 percent for France and a rise of 44 percent for Germany. On the other hand, official or quasi-official foreign debts incurred by Italy and the UK in the 2-3 years following the OPEC price increases of 1973-74 were estimated to have been about twice those incurred by France.(1)

D. Competitiveness in International Trade

The fact that the oil-producers' surplus must be matched by a deficit by the rest of the world has sometimes been extended into an argument that trade deficits do not really matter and that it is ungentlemanly for a country not to accept its due share of the overall world deficit. The OPEC surplus, however, has been decreasing regularly since 1974 with increasing imports. Since our interest is in the relative competitiveness of our four countries, the non-oil trade balance is an interesting, albeit crude, indicator (see Table 4).

The figures confirm the overwhelming strength of the German trade balance, which has remained in customary (overall) surplus after abosrbing the impact of increased oil prices in 1974-75, while the (overall) trade balances of the three have been in deficit. Looking at the non-oil trade balance, one can see that France has been in surplus every year from 1972 to 1977, the UK in deficit every year except 1977 (largely thanks to depressed domestic demand), and Italy improving its performance (from deficits in 1973 and 1974 to surpluses in 1975, 1976 and 1977).

This divergence can also be seen by comparing export performance over the entire period 1955-1977 (Table 5). Over the period, the UK's share of total OECD exports of manufactures fell from 20 percent to less than 10 percent (it had been 25 percent in 1950). Italy increased its share from under 4 percent to over 7 percent; France increased its share marginally, from around 8 percent to over 9 percent; while Germany increased its share from around 16 percent to around 20 percent.

The picture suggested is one of underlying French resilience, underlying British weakness, and improving Italian performance after a period of disruption to a dynamic underlying trend.

E. Inflation

Before the 1970s, there was not much divergence in inflation rates between the four countries (Table 6) though Germany had a lower rate than the others. In the 16 years from 1955 to 1970, the average rate of inflation was 3.6 percent for the UK, 3.2 percent for Italy, 4.4 percent for France and 2.3 percent for Germany. Both Italy and France actually experienced price decreases at different times during this period. If 1958 were excluded from the period for France, the 15-year average inflation would be 3.6 percent, the same as for the UK.

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(1) US House of Representatives, Committee on International Relations, Economic Conditions in Italy, France, and the UK, Washington 1978.

TABLE 4

Visible trade balance 1972-1978

	1972	1973	1974	1975	1976	1977	1978
UK, £ million							
Exports FOB	9,906	12,657	16,820	20,111	26,024	33,308	
Imports CIF	11,301	16,067	23,492	24,423	31,569	36,996	
Crude Petroleum (net)	914	1,296	3,726	3,369	4,448	3,967	
Trade balance	-1,395	-3,410	-6,672	-4,312	-5,545	-3,688	
Non-oil trade balance	-481	-2,114	-2,496	-943	-1,097	+279	
Italy, billions of Lire							
Exports	10,849	12,969	19,826	22,750	31,165	39,736	
Imports CIF	11,265	16,224	26,715	25,090	36,334	41,960	
Crude Petroleum	1,431	1,984	6,274	5,355	7,462	8,616	
Trade balance	-416	-3,255	-6,889	-2,340	-5,169	-2,224	
Non-oil trade balance	+1,015	-1,271	-615	+3,015	+2,293	+6,392	
France, billions of Francs							
Exports	133.4	162.5	222.1	227.2	273.2	319.2	
Imports CIF	136.2	167.2	254.2	231.2	308.1	346.4	
Crude Petroleum	13.6	15.8	47.4	41.6	55.2	58.3	
Trade balance	-2.8	-4.7	-32.1	-4.0	-34.9	-27.2	
Non-oil trade balance	+10.8	+11.1	+15.3	+37.6	+20.3	+31.1	
West Germany, billions of DM							
Exports	149.0	178.4	230.6	221.6	256.6	273.6	
Imports CIF	128.7	145.4	179.7	184.3	222.1	235.2	
Crude Petroleum	7.4	9.1	23.0	19.7	23.8	23.5	
Trade balance	+20.3	+33.0	+50.9	+37.3	+34.5	+38.4	
Non-oil trade balance	+27.7	+42.1	+73.9	+57.0	+58.3	+61.9	

Source: IMF, International Financial Statistics.

TABLE 5

Percent Shares of Total OECD Exports of Manufactures

	U.K.	Italy	France	Germany		Japan	U.S.A.
1955*	19.6	3.4	9.3	15.4		5.2	24.7
1956	19.0	3.6	7.8	16.4		5.7	25.4
1957	18.0	3.8	8.0	17.5		6.0	25.5
1958	18.1	4.1	8.6	18.5		6.0	23.4
1959	17.7	4.4	9.2	19.1		6.7	21.3
1960	16.3	5.1	9.7	19.3		6.9	21.7
1961	16.2	5.7	9.4	20.3		6.8	20.6
1962	15.6	6.0	9.2	20.0		7.5	20.4
1963	15.4	6.1	9.2	20.3		7.8	19.8
1964	14.2	6.4	8.9	19.7		8.3	20.4
1965	13.5	6.8	8.8	19.2		9.4	20.5
1966	12.9	6.9	8.6	19.5		9.8	20.2
1967	12.2	6.9	8.5	19.6		9.8	20.5
1968	11.6	7.3	8.2	19.4		10.7	20.3
1969	11.3	7.3	8.2	19.5		11.2	19.3
1970	10.8	7.2	8.7	19.8		11.7	18.5
1971	10.9	7.2	8.8	20.0		13.0	17.0
1972	10.0	7.6	9.3	20.2		13.2	16.1
1973	9.4	6.8	9.5	22.1		12.8	16.1
1974	8.8	6.7	9.3	21.7		14.5	17.2
1975	9.3	7.5	10.2	20.3		13.6	17.7
1976	8.8	7.1	9.7	20.5		14.6	17.2
1977	9.4	7.6	9.9	20.7		15.4	15.5
1978							

Note * : In 1950 the UK's share was 25.5 per cent.

Source : National Institute Economic Review, various issues.

TABLE 6

Increase in consumer prices, percent per annum

	U.K.	Italy	France	Germany
1955	4.3	2.3	1.0	2.2
1956	5.4	3.4	4.3	2.2
1957	3.7	1.2	-0.7	2.9
1958	3.0	2.9	15.4	0.7
1959	0.6	-0.5	5.7	1.0
1960	1.0	2.4	4.1	1.2
1961	3.4	2.1	2.4	2.5
1962	4.3	4.6	5.2	3.0
1963	1.9	7.5	5.2	2.9
1964	3.3	5.9	3.1	2.4
1965	4.8	4.6	2.5	3.4
1966	3.9	2.3	2.7	3.5
1967	2.5	3.2	2.7	1.4
1968	4.7	1.4	4.5	2.6
1969	5.4	2.6	6.4	1.9
1970	6.4	5.0	5.2	3.4
1971	9.4	4.8	5.5	5.3
1972	7.1	5.7	5.9	5.5
1973	9.2	10.8	7.3	6.9
1974	16.0	19.1	13.7	7.0
1975	24.2	17.0	11.7	6.0
1976	16.5	16.8	9.6	4.5
1977	15.9	17.0	9.8	3.9
1978				
Arithmetic mean 1955-70	3.6	3.2	4.4	2.3

Source: OECD Main Economic Indicators

IMF International Financial Statistics

Towards the beginning of the 1970s for Germany and the end of the 1960s for the others, one can detect a slight tendency for inflation rates to increase. Beginning in 1971 with the UK, and 1973 for Italy and France, the rate of inflation accelerated markedly, to reach the peak of 24 percent in the UK in 1975, 19 percent in Italy in 1974 and 14 percent in France in 1974, while German inflation was contained below 7 percent throughout. Thus, the major divergence has been between Germany and the rest. Of the three countries, France weathered the inflationary cycle best, returning to single digit rates by 1976, two years ahead of the UK and Italy.

Inflation in the 1970s cannot be blamed solely on the commodity boom and the oil price increases. In 1974, the year in which commodity prices peaked (while oil prices increased 360 percent between January 1973 and January 1974), commodity and oil price increases were estimated to have contributed, in a direct, statistical sense, to between 28 percent and 31 percent of the increases in consumer prices in Italy, France and the UK, and 42 percent in Germany(1). What happened was that the external price increases magnified inflationary tendencies which already existed domestically, especially in the UK and Italy. In these two countries, unprecedented wage increases (of over 25 percent) combined with declines in the exchange rate to propel inflation independently of external shocks. In France, the situation was brought under control more quickly, due, inter alia, to strong government resolve, a less militant labour force, greater self-sufficiency in food, and smaller declines in the exchange rate. This helps to explain France's greater confidence in joining the EMS, while the greater priority attached to price and political stability helps to explain some of the motives. As for Germany, the citadel of stability, the rising value of the Mark helped to absorb external shocks, while the extraordinary degree of social consensus owes much to memories of the past as well as an authoritarian tradition.

II. The Common Market and the Promotion of Convergence

The factor price equalisation theorem of neo-classical international trade theory states that, under a number of assumptions, free trade would equalise the prices of the same factors of production in the different countries. To put it very crudely, under free trade a labour-abundant country would export labour-intensive goods and a capital-abundant country would export capital-intensive goods. The increased demand for the abundant factor would drive up the price of labour in the former country and the price of capital (or land, or whatever was assumed to be the second factor of production) in the latter, and this process would go on until factor prices were equalised between countries, despite the absence of factor movements between countries. Now according to neo-classical theory itself, there are many theoretical reasons why the process may be stopped before factor prices become equal in the two countries concerned,

(1) OECD Economic Outlook, July 1974.

and this is where international mobility of factors come to the rescue. If trade alone, without factor movements across national boundaries, can equalise or at least reduce international differences in factor prices, how much faster and more thoroughly can these differences be reduced if factors can move freely from countries where they are in relative surplus to countries where they are scarce?

It is debatable to what extent the founders of the Common Market were really influenced by these theories (after all, it is now almost a truism to say that the creation of the EEC was a political act motivated by political and strategic considerations). Nevertheless, the design of the Treaty of Rome is certainly consistent with, and can easily be understood with reference to, the broad and superficial conclusions of neo-classical theory (moreover, the Germans, the Italians under De Gasperi, and the Dutch 'officially' believed in the market economy and free international trade). Thus, if free trade might not equalise factor prices, this might be because trade was not really free or because of transport costs; hence the emphasis, in the Coal and Steel Community and then in the EEC, on removing non-tariff barriers to trade (NTBs) as well as tariffs and quotas, hence also the emphasis on a common transport policy, hence the emphasis on removing all kinds of real or perceived 'distortions' such as public procurement rules. Moreover, the customs union was to be effectively buttressed by the free circulation of people and capital. Even if absolute equalisation of factor prices cannot be obtained in the short term, something less than that, but in the same direction, in other words, convergence of factor rewards, must prevail.

Over the years, the hold of neo-classical liberal economic theory has declined, and the stubborn persistence of regional disequilibria within countries has given rise to a concern for regional policy. The most powerful theoretical criticism of the convergence philosophy probably comes, however, from the view of circular or cumulative causation and backwash effects. The rich or successful country or region becomes richer and the poor poorer, because the rich has certain advantages which free trade and free factor movement reinforce. The rich attracts capital, qualified labour, technology, etc, which enable it to further expand its exports, which raises income levels, which attracts capital, labour, technology, etc.

III. Different National Postures in the EC

In terms of the underlying resilience and dynamism of their economies, the major divergence is between the UK on the one hand and the rest. Italy possesses economic characteristics which differ widely from those of the UK. Its industrial structure and business community appear to be more flexible and dynamic. Whereas Italy's economic problems are mainly due to political and social difficulties, it would not be unfair to say that Britain's political and social problems arise from long-standing economic conditions.

In terms of income levels in purchasing-power parity terms, the main divergence is between Italy and the UK on the one hand, and France and Germany on the other, with the French being very close to the Germans. In terms of inflation, the major divergence is between Germany and the three, though France appears to have brought the situation under control more rapidly and more effectively than the UK and Italy.

These divergences help to explain, to some extent, the policy stances being adopted by the four countries. France has both the confidence and the motivation to join with Germany as the two major powers in the EMS, since it has the strongest economy after Germany among the big EEC countries, has been more effective in controlling inflation than the UK or Italy, and attaches a high priority to price stability as well as political stability. If Germany can do it, why can't France? And the example of Italy is a warning to keep the Left under control, if need be with the help of Europe.

Italian references to political forces other than national governments point to her internal problems with trade unions and the political system. The Italian establishment is looking to Europe to help deal with internal political and social problems. External financial discipline is seen as useful. Eventual political union may help to reinforce government authority in Italy.

The formation of the EEC has coincided with the golden age of post-war growth for the Six. Whether and to what extent prosperity was due to the Common Market cannot be known with utter certainty, since one does not know what would otherwise have happened over such a long period of time. But the point is that in the Six perceptions are that the two are intimately linked. France, under de Gaulle, used the opening up of French industry to the EEC to stimulate it into improving its competitiveness. Italy specialised in the production and export of consumer durables. Germany saw the EEC as a bulwark for free trade and a framework for her political legitimacy. The UK joined when the world recession was about to begin, expected quick results, but was not prepared to improve industrial competitiveness and increase industrial investment. Britain's poor economic performance and low standard of living lead her to resent paying more than her 'fair' share of the EC budget.

All this is complicated by divergences in policy stances and in economic philosophies. Germany, and to some extent France, have taken the view that the present recession is a structural one which cannot be overcome by stimulating global demand. Recovery must take place via a revival in private sector investment (German language) or industrial redeployment (the French slogan). The UK (and the US) have asked for co-ordinated reflation of demand by the major economies, coordination being required to overcome the leakages that would bring single-handed reflation to a halt. Italian industry is also prepared for structural adjustment within an EEC context. There are also divergences concerning free trade versus protectionism.

IV. Does Economic Divergence Matter to the EC?

Can the European Communities (EC) continue to exist under the strain of persistent and most probably increasing economic divergence? If so, why should economic divergence be considered a major issue (if indeed it is), and by whom? Why should the Communities promote convergence? How can it do so?

It may be worth pointing out that projecting divergent trends into the future does not, per se, answer the 'so what' question. Moreover, in debates at the community level, the terms divergence and convergence are rich in nuances (which helps to explain their popularity); thus, divergence can refer to divergence of viewpoints, interests, performance (including income levels), structure and policies, to name but a few, whereas calls for convergence may refer to convergence of policies or convergence of performance. Convergence of economic policies does not necessarily lead to convergence of economic performance, for the simple reason that the effectiveness of a given set of policies may vary according to the milieu in which they are applied.

Now some of the problems or failures that have been plaguing the EC have little to do with divergent economic performance. The fisheries dispute, for example, is due mainly to the fact that the EC consist of independent nation-states whose interests clash over who is going to fish where. One may question whether the countries concerned are right in adopting a narrow rather than a wider interpretation of their national interests, but it is difficult to avoid the conclusion that the clash over fishing rights would have occurred even if there had been greater convergence of economic performance (though it might have been less acrimonious). The same reasoning can be applied to the failure to evolve a real community energy policy. Some countries have energy resources in their territories, others do not, and the interest of all cannot be made to prevail over the interest of each (which again may be taking a rather narrow, short-term view of its national interests). Similarly, the EC's failure to display solidarity in the face of the Arab oil embargo in 1973 had nothing to do with divergence of economic performance. In advanced-technology industries, the slow progress of a community policy can hardly be blamed on divergent growth rates of GNP or divergent inflation rates.

Given the afore-mentioned divergences in national interests and/or in countries' perceptions of their own interests, does it follow that divergence of economic performance does not matter? The answer must be 'no'. In this paper I can only suggest some of the reasons instead of providing a comprehensive model.

A fundamental reason is that divergence, in the context of close interdependence, generates political and psychological tension which may become unbearable. The qualification should be stressed: divergence between two distant countries creates no more problems than did divergence between the Roman and Chinese Empires twenty centuries ago. Close contacts and interdependence, however, put into stark relief the unevenness of power. The closer the bonds, the more troublesome is inequality, for there will be a permanent temptation to exploit or reverse it.

> 'Interdependence among unequals is likely to be recurrently unbearable both to the very strong and to the very weak. It will be unacceptable to the very strong, if they are constantly summoned to make sacrifices on behalf of the weak and, so to speak, to subsidise them in order to prevent the system's unraveling, especially if such help would either save the weak from having to shape up, or allow them to challenge their benefactor - an experience which many Americans resented in the 60's and which led to the reassertion of national power in 1971; an experience which many West Germans resent now, in dealings with their EEC partners....And the terms of interdependence will be unacceptable to the weak, if they have means of redress.'(1)

(1) Stanley Hoffman, Domestic Politics and Interdependence, in OECD, From Marshall Plan to Global Interdependence, Paris, 1978.

In a sense then, the major discrepancy is between Bonn and its partners in the EC, with Bonn having to keep its weaker partners from imposing unilateral trade restrictions and from undergoing drastic political upheavals through economic disruption. In a sense, however, the major discrepancy is between Britain and the rest, with Britain having been great (unlike Ireland or Italy) and now being poor, where there are people only too ready to attribute its economic ills to outside causes instead of looking within, and whose behaviour since joining the ECsgives rise to apprehensions that she is out to get what she can in a club of the rich. It may also be noted that, at the level of philosophies and policies, the German model has much currency on the continent. The French establishment appears to be currently mesmerised by what they think is the German model, and a former Belgian Minister of Economic Affairs was able to write:

> 'Notre volonté de rigueur s'exprime dans notre détermination de rester inébranlablement au sein du serpent monétaire européen, c'est à dire de ne pas nous laisser distancer de la politique clairvoyante de nos voisins et partenaires allemands.'(2)

The significance of the tensions and suspicions generated by divergence of economic performance is that they make attempts at common policies that are much more difficult. In any common endeavour, there has to be a certain amount of give and take, of mutual trust if the enterprise is to succeed. The tensions created by divergence of performance come as an additional obstacle to the barriers of different histories, traditions, attitudes, and national interests and to the problems due to world economic upheavals. Moreover, as a 'means of redress', the UK and France have not hesitated to hold up progress on common policies <u>independently</u> of the merits of the policies themselves: for example, the UK vetoing proposals in the energy field unless the regional fund was approved first, France vetoing the entry into force of the EMS unless MCAs were first phased out.

At a more mechanical level, divergence of economic performance, if allowed to develop unchecked, may interact with some community policies to threaten the existence of the ECs or to produce situations considered as unacceptable to some member countries. At the very least, such divergence may hinder the adoption or successful operation

(2) F. Herman, le marché commun et les états membres face à la crise économique, in <u>Studia Diplomatica</u>, 1976, no. 6.

of some new policies. Here it is useful to distinguish between two kinds of divergences of economic performance: divergence in monetary phenomena (principally rates of inflation) and divergence in real phenomena (mainly growth rates and income levels).

Monetary divergence obviously makes it more difficult to adopt and implement an EMS or an EMU, though the possibility of occasional devaluations or revaluations within the EMS should remove many of the fears. In the past, divergent currency movements have played havoc with the principle of common prices in agriculture, and, combined with the slowness of governments to adjust their green rates in line with market rates, have led to the introduction of MCAs which lie at the heart of the recent Franco-German dispute, with the French arguing that MCAs subsidise agricultural exports from the strong currency countries and penalise exports from the weak currency countries to the strong currency ones.

For the Community, one of the most serious implications of growing disparities in income levels between member states relates to the legitimacy of the CAP and the Community Budget, both representing acquis communautaires painstakingly built up over the years. Given the community doctrine that community budget transactions are determined by the policies that give rise to them and not by ability to pay or the principle of juste retour, increasing disparities in income levels at market exchange rates(3) will provoke increasing resistance by the poorer countries if they have to pay more than their 'fair' share. This problem was recognised when the EC instituted a financial mechanism for the repayment of excess contributions to the Community budget, as a result of the British renegotiations of membership. Given continuing poor British economic performance, however, Britain has not been pacified, and British demands have escalated from limits on gross payments to the whole question of net transfers into or from the community budget, a corollary of which is a questioning of the pattern of Community expenditures and hence of the CAP. Given that the CAP represents 'our most highly developed and most integrated form of common action'(4) and that the Own Resource formula was arrived

(3) These may come about in two ways: as a result of divergent growth rates where the high income countries grow faster and as a result of divergent currency movements. Since international transactions are conducted at market rates of exchange and not at shadow rates, it is GNP per capita at market rates that matters here.

(4) Tindemans report.

at after years of effort, and also in view of the fact that Britain has not exactly done everything to facilitate greater Community spending that would benefit her (regional fund, energy policy), it is questionable whether she will obtain much satisfaction. Meanwhile, Italy, the other great loser under the community budget, has kept a much lower profile, partly perhaps because of a greater commitment to the European idea, but also because, in Italian perceptions, the country as a whole did benefit, in growth terms, from the EEC.

But things are not likely to stay here, for we do not live in a static world. If German, Benelux and French GNP per capita continue to rise in relation to the UK and Italy, either because of higher growth in volume terms or because of more favourable currency movements, food prices in EUAs must rise too, both because of the way the EUA is calculated, and because farmers' incomes (hence food prices, under a system of price support to maintain farmers' incomes) in terms of national currencies cannot be left too far behind. These higher food prices, which consumers in the more prosperous countries will find easy to absorb, may become 'unbearable' in the less prosperous countries. The alternative would be to abandon the principle of common prices in agriculture, and thus abandon one of the pillars of the CAP, with consequences which some countries may judge to be incalculable. This problem will also manifest itself in terms of budget contributions.

Supposing that the EC were eventually persuaded that gross or net contributions to the budget should be graduated according to ability to pay. The countries with a shrinking share of total EC GNP would then be contributing a shrinking share of the EC's budget and resources. Would it not be logical for their voting rights to be reduced too, in the same way that voting power in the IMF and the World Bank depends on financial contributions?

Turning now to the industrial area, the other major achievement of the EC, free trade in industrial products, may also be threatened by unilateral trade restrictions by the less prosperous countries if divergence continued and if they came to see restrictions as the only means of redress. Already now, it would appear that community rules on competition, state aids, etc are coming into conflict with government policies in the poorer performers.

What can the community do to promote convergence of economic performance? In a sense rather little, since growth and competitiveness depend largely on the countries concerned themselves, on attitudes, social structures, government policies, entrepreneurial spirits, etc. Net transfers to and from the community budget are too small in relation to GNP to have a significant impact per se, but may not be small in relation to the current balance of payments. Food prices are likely to have a much more important effect on economic performance than budget contributions, especially for a country like Britain which has traditionally relied on cheap food imports to compensate for lower labour productivity.

Current attention in Britain is focussed on the issue of the transfer of (financial) resources via the community budget and the CAP. Britain's partners may, however, well reason that financial resources are not the crux of the matter. After all, Britain has the revenues from North Sea oil. Why can she not utilise these resources to modernise her economy? And if she cannot, what assurances have the community that resources transferred to Britain will not go down the drain? If problems in Britain and Italy are seen as being due to internal weakness, then it makes sense to provide loans rather than grants, and to use the loans to improve performance, either through project formulation and supervision (by the EIB) or through macro-economic conditions (for community loans). And this indeed seems to be the way the community is moving. Meanwhile, the regional fund will not have much of an impact on divergence between countries (especially large ones) rather than between regions, nor, in the eyes of Britain's partners, was it designed as a transfer mechanism between countries.