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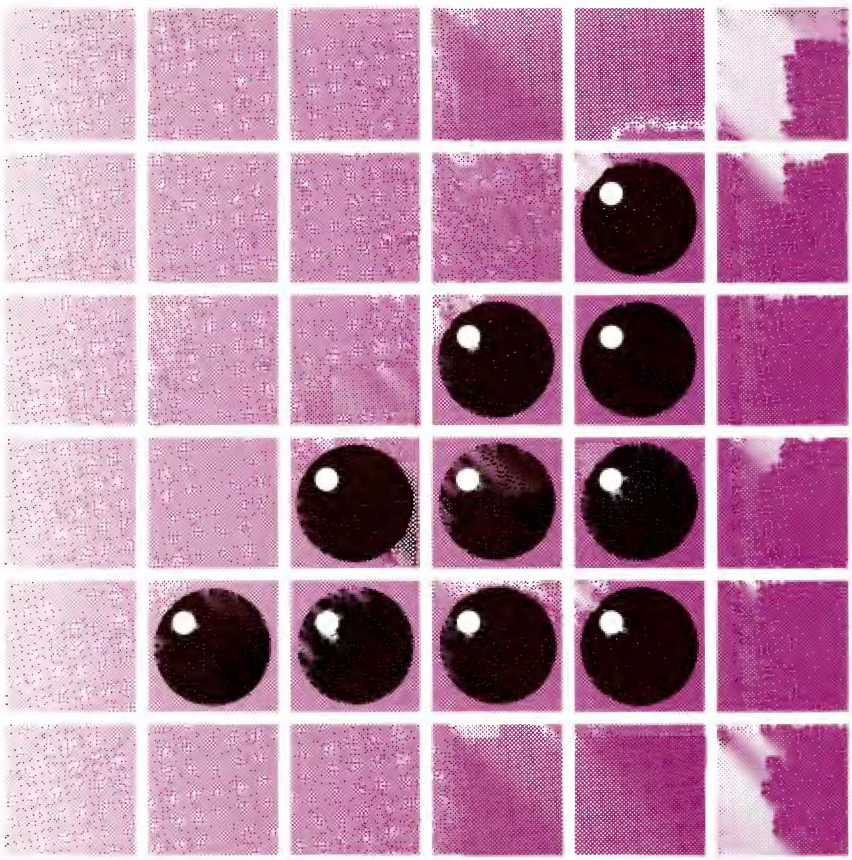
THE ECONOMY OF THE EUROPEAN COMMUNITY



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Contents

Introduction — What kind of economic community?

Ten European countries, with a combined population of 273 million, are engaged in an unprecedented experiment — the establishment of an economic community aimed at strengthening their economic potential so as to raise the standard of living of their peoples and improve the organization of their relations with the rest of the world.

That this experiment is viable and meets a need deeply felt in the Member States is demonstrated by the fact that not only has it stood the test of time over a quarter of a century, but the original membership of six (Belgium, Federal Republic of Germany, France, Italy, Luxembourg and the Netherlands) has been expanded to 10, with the accession of Denmark, Ireland and the United Kingdom in 1973 and that of Greece in 1981.

In today's world, with the rapid advance of technological development placing a premium on large-scale producion, the emergence of new economic powers and the urgent need — despite the difficulties — of more satisfactory relations with the developing countries, the formation of a vast integrated economic entity in Europe remains the most solid assurance of lasting prosperity for its Member States, while for the rest of the world it is a key factor in the establishment of a new international economic order.

However, economic arguments and the dynamics of economic forces are not enough in themselves to make countries embark upon the course of true integration; it was an awareness of economic needs coupled with a political will that inspired the Treaty of Rome (25 March 1957), an original formula for the creation of an economic community which had no precedent in history. It is awareness of today's economic needs coupled with sustained political will that will enable the Community to continue to make progress.

Section 1. Degrees and stages of economic integration

For medium-sized or small economies like those of countries in Europe, there is no lack of economic arguments in favour of developing trade relations with the outside world: the need to secure certain essential imports such as energy, raw materials and tropical agricultural produce; the need to participate in some form of international division of labour in order to benefit from the economies of scale than can be achieved with large production units or with mass production, and to enjoy the stimulus of competition; the need to import technology (either by purchasing plant and equipment or by securing patent rights and licences), it being impossible for any one country to explore all areas of research; and lastly, the fact that importing also affords consumers a wider choice of goods on the market.

All these factors argue in favour of trade relations with other countries. Such relations can take any of a variety of forms, which are outlined below, according to the degree of integration that they involve.

The list begins with the most widespread form of relations: foreign trade with barriers, which may be quota restrictions, customs duties or non-tariff barriers. Although there have been no quota restrictions since 1958 between the countries which are party to the General Agreement on Tariffs and Trade (GATT), the other barriers subsist, although they have been lowered under agreements concluded at the end of the Kennedy Round (1968) and the Tokyo Round (1979).

A more ambitious stage leads to the establishment of a free-trade area or a customs union. Customs duties, which are abolished between member countries, are maintained in trade with third countries; where they continue to differ from one member country to another, the arrangement is that of a free-trade area, whereas, if the same duties are charged by all member countries, it becomes a customs union in the full sense.

However, creating an area within which goods are allowed to move freely is not sufficient in itself to achieve maxiumum efficiency of the productive system, which requires specialization by manufacturers based on a real international division of labour, and hence the location of companies or production units where they can realize their full potential in terms of efficiency. This calls for mobility not only of goods but also of the factors of production themselves, namely labour and capital.

Disparities in regulations, particularly in taxation systems, from one country to another perhaps represent the greatest obstacle to the achievement of an ideal geographical distribution of the factors of production.

Hence the motivation for the creation of a common market. Following upon the abolition of quotas, customs duties and technical obstacles to movements of goods, action is taken to introduce freedom of movement for persons (through the adoption of a variety of measures concerned, for instance, with reciprocal recognition of qualifications), free movement of capital (through tax harmonization and abolition of all exchange controls) and freedom of establishment throughout the territory of the common market.

Is such a structure sufficient for the purpose?

There are two very strong arguments in favour of a much more elaborate structure. The first is that this conception of the common market, in which the factors of production enjoy freedom of movement and there is a minimum degree of tax harmonization, fails to take account of the substantial extent to which the State intervenes in the running of its national economy. Without harmonization — and even unification in some areas — of the role of public authorities in their respective economies, there are bound to be differences from one country to another in the relative influence of the various factors entering into industrial decision-making, which will be reflected in choices of locations, specializations and production methods.

The second argument is that, since the opening-up of markets makes the economy of each member country more sensitive to developments in the others, it is necessary to have arrangements ensuring that all member countries pursue compatible short-term economic policies.

In order to attain the twofold aim of harmonizing (and in some cases unifying) public intervention in national economies and securing a minimum level of consistency in short-term economic trends, it is necessary to go beyond the common market and harmonize economic policies to the requisite extent, in other words to create a true economic and monetary union.

It should be made clear that harmonization does not require identical measures to be adopted throughout the territory of the Community; on the contrary, structural and behavioural differences between the economies of individual countries can justify the use of a variety of instruments. However, harmonization does require arrangements to check that such instruments are consistent, and it also calls for agreement on the aims envisaged. Another consideration is the great speed with which certain economic decisions have to be taken. These various requirements point to the usefulness of progressing beyond the stage of an economic union as such and establishing a minimum degree of political union. This is therefore the logical culmination of any move towards economic integration. It does not mean the complete extinction of the national State, but the creation of a Community political authority to which certain powers are explicitly devolved.

The Treaty of Rome contained detailed provisions for the organization of the common market as well as a number of arrangements laying the foundations for economic union; further progress has been achieved through subsequent decisions, based on Article 235 in particular, as will be seen in the chapters that follow.

Section 2. Transfers of powers from national authorities to the Community institutions

Community action outside those fields that remain the exclusive preserve of national or regional authorities can take any of four main forms corresponding to a graduated scale of integration, beginning with exchanges of information and ranging through consultation and coordination to a common policy.

The situations that the provisions of the Treaty of Rome (and subsequent treaties or agreements, where relevant) have created as regards the allocation of powers between national authorities and the Community institutions break down into four main categories:

(i) powers of national authorities unchanged; in this situation the Community institutions have no influence over instruments used at national level (although they can organize Community action which overlaps with national action, the clearest example of this being provided by the European Social Fund);

(ii) powers of national authorities modified, by provision for discussion between partners, which may take the form of exchanges of information or official consultation;

Transfers of powers from national authorities to the Community institutions

Instruments	Powers of national authorities	Role of Community institutions	
		Influence on national decisions	Own decisions
Public finances Current expenditure	Unchanged (but non-discrimination between suppliers)	Directives (adopted or proposed) on procedures for award of public contracts	
Public investment	Modified (discussions)	Moves toward consultation, particularly in transport and energy	
Transfers to individuals	Unchanged (provided no discrimination between nationals of different Member States)		Social Fund
Operating subsidies to undertakings	Limited (monitoring by the Commission)	Verifying compatibility with the common market (Arts 92 and 93)	EAGGF
Capital subsidies	Limited (monitoring by the Commission)	Verifying compatibility with the common market (Arts 92 and 93)	The Commission has proposed principle of development to industry

Transfers to the rest of the world	Unchanged		European Development Fund
Indirect taxes	Limited: prohibition of discriminatory taxes (Arts 95 to 98)	Monitoring of non-discrimination and tax reductions	ECSC levy
	monitoring of tax reductions (Arts 92 and 93)	Proposals for harmonization (based on Art. 99) (moves towards alignment of VAT rates)	Own resources (Treaty of 22.4.1970)
	general introduction of the VAT system (decision based on Art. 99)		
Direct taxes on personal incomes	Unchanged		
Corporation tax	Unchanged	Proposals for harmonization (based on Art. 99)	
Customs duties: - intra-Community	Abolished: duties abolished (1.7.1967)		Fixing of CET and rates for agricultural levies
- third countries	Abolished: introduction of the common external tariff (1.7.1967) (special cases of the associated States in Africa and Madagascar; generalized preferences for developing countries from 1.7.1971)		
Social security contributions	Unchanged	Social security scheme for migrant workers	

Instruments	Powers of national authorities	Role of Community institutions	
		Influence on national decisions	Own decisions
Property tax and estate duty	Unchanged		
Transfers from the rest of the world	Unchanged		
Loans to undertakings	Limited (insofar as loans are construed as State aid — Arts 92 and 93)	Verifying compatibility with the common market	ECSC loans EIB (European Investment Bank) loans
Loans to the rest of the world	Unchanged		
Borrowings from the home market	Unchanged		The ECSC and EIB can barrow on the markets of Member States orthird countries
Borrowings from the rest of the world:			
- intra-Community	Unchanged		
- third countries	Unchanged		
Balance on current transactions	Modified	Council opinion on short-term economic policy	
Balance on revenue and expenditure	Modified	Council opinion on short-term economic policy	

Regulations directly affecting certain economic parameters			
A — *Money and credit*			
Direct monetary instruments (rediscount rate, open-market transactions, etc.)	Modified	Moves towards consultation (Monetary Committee, Short-term Economic Policy Committee, Committee of Governors of Central Banks)	
Regulation of bank lending	Modified	Moves towards consultation (Monetary Committee, Short-term Economic Policy Committee, Committee of Governors of Central Banks)	
Regulation of capital transactions	Unchanged		
Exchange controls: – *vis-à-vis* Member States – *vis-à-vis* third countries	 Abolished Unchanged	 Possibility of authorization by the Commission	
B — *Other regulations directly fecting certain economic parameters*			
Regulation of prices	Limited Abolished in the case of coal, steel and agricultural products		Fixing of agricultural prices, monitoring of coal and steel price lists

Instruments	Powers of national authorities	Role of Community institutions	
		Influence on national decisions	Own decisions
Regulations of salaries and wages	Limited: prohibition of discrimination based on nationality (Art. 48) equal pay for equal work for men and women (Art. 119)		
Exchange rate adjustments	Limited (prior consultation)		
Regulation of imports and exports trade agreements:			
– intra-Community	Abolished (free movement)		
– with third countries	Abolished (common commercial policy)		Formulation of a common commercial policy; negotiation with third countries
Institutional framework and rules and regulations			
System of property ownership	Unchanged		
Commercial legislation	Modified (moves towards approximation)	Directives for the approximation of provisions directly affecting the functioning of the common market (Art. 100)	
Rules on competition	Modified by the precedence taken by the Community rules		Monitoring application of Arts 85 and 86

Regulation of working conditions	Limited: prohibition of discrimination based on nationality (Art. 48) maintenance of equivalence between paid holiday schemes (Art. 120)	Studies and opinions to promote close cooperation	
Technical regulations	Limited	Directives for the removal of technical barriers to trade (Art. 100)	
Immigration controls			
– Member States	Abolished (free movement of workers, freedom of establishment)		
– third countries	Unchanged		
Economic information	Unchanged	Medium-term programme	Statistical Office of the Euro pean Communities

(iii) competence of national authorities limited:
  - either by a binding requirement for coordination of harmonization among Member States,
  - or by the need for Commission authorization;

(iv) powers of national authorities abolished; here, decision-making powers lie with the Community institutions (either under the general procedure, with a proposal from the Commission followed by a Council decision, or under the special procedure for decision-making by the Commission in the cases specified in the Treaty, or when powers are delegated to it by the Council).

The table gives a general list of the instruments of economic policy showing the theoretical allocation of powers as determined by the Treaty and other texts.

Section 3. The European Community experience over 25 years

The last quarter-century has seen a radical transformation in the economy of the European Community. A few statistics are enough to give a first impression of these changes (all figures are for the Community of Ten, even though there were originally only six member countries).

The Community's population has increased by 16%, from 236 to 273 million. But this is still no more than 6% of the world population.

Its total GDP, at constant prices, has almost trebled. In 1982 it was 2 400 000 million ECU, as against 2 600 000 million in the United States and 1 100 00 million in Japan. Although it has increased considerably per head of population, and now stands at 8 883 ECU, this figure is still lower than that for the United States (13 283) and broadly matches that for Japan (9 064).

There have been fairly wide differences in performance between the countries, however. The following table gives the movement of per capita GDP (figure as a percentage of the Community average).

	1960	1972	1980	1983
Belgium	97	104	107	105
Denmark	110	117	110	118
FR of Germany	114	112	114	114
Greece	37	54	56	54
France	99	108	110	111
Ireland	62	63	64	63
Italy	79	86	88	87
Luxembourg	146	112	119	116
Netherlands	105	104	106	102
United Kingdom	117	99	93	95

NB: Comparisons are based on purchasing power parities.

For 10 years, prices were more or less stable: the rate of increase of the general prices index averaged 4%, with little difference between the rates for the individual countries. In 1969, however, inflation began to intensify, averaging 9.9% a year for the period 1971 - 80 (with a peak of 15% in 1975) and — even more serious for a common market — attaining rates which differed widely from one country to another (ranging from 5.2% to 14.8% over a 10 year period).

External trade has also been radically transformed: intra-Community exports have increased from 5% to 13% of GDP, reflecting the existence of the common market. At the same time, trade with the rest of the world has grown from 10% to 13%, making the Community the most open economic area of the world, given its size (the larger an economic area, the more self-sufficient it can be): the figure for the United States is markedly lower (9%) and, although the Japanese figure is of the same order of magnitude (14%), it must be noted that the Japanese economy is only about one-third as large.

The following chapters consider how the functioning of the Community has brought about these changes and how it can help us to meet the challenges of the future, namely:

(i) improving efficiency by influencing production structures;

(ii) improving employment and securing greater convergence through economic and monetary union and the European Monetary System;

(iii) showing solidarity in the search for a caring economy;

(iv) organizing economic relations with the rest of the world.

The booklet ends with a review of decision-making structures, the budget and medium-term planning.

Chapter I — Establishment of an efficient community: structuring of productive activity

Improving the efficiency of Member States' economies is one of the basic aims of the Treaty of Rome, since it is essential to the achievement of 'economic and social progress' and the 'constant improvement of the living and working conditions of their peoples' (preamble).

In the decentralized, market-based economic system that prevail in the countries of Western Europe, efforts towards the achievement of such efficiency are conventionally based on two approaches:

(i) the formation of a large market affording free movement of goods (giving consumers a wide range of choices) and of the factors of production (which will gravitate towards the places where they can be employed most efficiently);

(ii) public intervention in various forms, aimed in particular at accelerating certain changes, regularizing others or stimulating production of certain goods.

These two approaches are to a large extent mutually complementary; the first provides a general framework in which the productive system can operate, while the second serves to rectify any imperfections or fill any gaps in the framework. All Western countries use both, although to differing degrees, and they were therefore legitimate subjects for treatment in the Treaty of Rome.

Section 1. Formation of a large market

The formation of a large market is based on three fundamental ideas:

(i) The customer, enjoys a wider choice when more potential suppliers are available.

(ii) Modern technology—particularly in industry, but also in many services—offers economies of scale. At least up to a certain point, unit costs are lower in large plants than in small plants (this holds in steelmaking, chemical engineering, oil refining, etc.); they are also reduced by the lengthening of production runs (in the motor industry, aircraft construction, mechanical and electrical engineering, etc.). The availability of a large market improves opportunities for achieving the size of plant or length of production runs that make for minimum costs.

(iii) Mobility of the factors of production (capital and labour) helps to ensure that they are employed in the industries and regions where they can operate with greatest efficiency.

The first and second of these arguments call for arrangements allowing free movement of goods throughout the territory of the Community; the third goes further, requiring freedom of movement for persons and capital, and freedom for any national of a Member State to set himself up or establish a business anywhere in the Community. Specific provision for such arrangements, which are sometimes referred to collectively as the 'four freedoms', is contained in Part Two of the Treaty, under Titles I and III.

However, abolition of obstacles deliberately placed in the way of free movement is not enough in itself, since a wide variety of public decisions (not confined to taxation) can obstruct the establishment of a genuine economically homogeneous area. Such an area is one in which choices of suppliers in decisions to buy goods or services and choices of sites in decisions on the location of production units are not influenced by the existence of political frontiers and economic disparities other than those deriving from geographical conditions and the legacy of the past, for instance as regards the state of infrastructures and the effects of regional planning.

As well as the removal of obstacles, it is necessary to have arrangements for monitoring or coordinating these various public decisions, especially those having a bearing on taxation and technical barriers to trade.

A — Free movement of goods

The general principle is that goods should be able to move freely throughout Community territory. Quotas for industrial products were abolished on 31 December 1961, and customs duties were abolished on 1 July 1968 for the Six, and on 1 July 1977 for the Nine. But, contrary to the public's wishes, the abolition of quotas and customs duties has not led to the complete abolition of checks at frontiers. There are still three major obstacles:

(i) taxation differences;

(ii) technical barriers;

(iii) the incomplete state of the customs union.

Because of the first two of the factors, it has been necessary to maintain certain tax procedures and controls at border crossings; because of the third, customs clearance formalities which should have disappeared over 10 years ago remain in force.

(a) Taxation differences

The situation in which tax systems or rates of taxation differ from one country to another is a potential source of distortion of competitive conditions prevailing in the Community as a whole. A producer in country A who has to pay VAT at 15% may consider that he is at a disadvantage compared with a producer in country B where the rate is only 10%, but in fact the realities of competitive conditions are more complex, depending on the overall tax system, not on any individual tax. Since the overall level of taxation is roughly the same in all EEC countries, a relatively low VAT rate will be offset by a relatively high rate of other taxes, such as income tax, and this is bound to have an effect on nominal incomes.

A complete answer to this problem would require total harmonization of tax systems. A very important first stage has been completed with the gradual adoption by all Member States of the value-added tax (VAT) system; it took some time to arrive at a common definition of the fiscal concept of value-added (which is not strictly identical to that accepted by economists), but this has now been established. Disparities between VAT rates remain, however, and they are substantial in some cases. Harmonization of the rates at which this indirect tax is charged would require some countries at least to undertake a radical revision of the balance between direct and indirect taxation; for instance, alignment of the proportion accounted for by direct taxes with the current level in the Federal Republic of Germany would lead to a reduction of almost 20% in rates in the Netherlands, but an increase of over 50% in France. Such changes would confront governments with serious difficulties. Moreover, unification of the rates of indirect taxation would necessarily mean that direct taxation would be the only remaining channel for differentiation of the overall tax 'take' (as a proportion of GNP) reflecting the various Member States' different conceptions of the scale (and uses) of public spending. Given the pressures for approximation of corporation tax with a view to reducing the influence of tax considerations as a factor in the choice of location for company headquarters, the outcome could be a situation in which personal income tax would be the only area still offering scope for adjustment.

Clearly, the scale of difficulties is such that there is no prospect of complete harmonization of rates in the near future.

In the words of the Commission:

'The harmonization of rates, which does not necessarily entail complete uniformity in all cases, will have to be carried out in several stages . . . '.

Pending such harmonization or at least significant approximation of rates, the problem created by the lack of uniformity has been dealt with by adopting the principle whereby a product attracts VAT in the place where it is bought; this means in practice that a product crossing a national frontier is subject to tax in the country of arrival at the rate ruling in that country, not in the country of departure (and of production). In contrast to the usual procedure, the tax is not collected at the time of production, but on crossing the frontier; hence the need for specific formalities.

(b) Technical barriers

This is the term used to describe obstacles to the movement of goods arising out of differences between regulations or standards applicable to products sold on the markets of the various Member States. Many of these regulations are motivated by safety considerations (minimum requirements to be fulfilled to ensure safety in the use of machinery, preliminary tests on pharmaceutical products to check that they are harmless), but others are prompted by the need for uniform standards (on such matters as the size of vehicle registration number plates, the sizes and shapes of electrical plugs, etc.) Only rarely are the terms of standards dictated on purely objective grounds, so that standards and regulations are bound to vary from country to country, with disruptive consequences for international trade. It is therefore necessary to establish harmonization among Member States, both by aligning existing standards and, in new fields, adopting common standards from the outset. With the modern world's rapid rate of technological progress, this is a perennial task.

(c) The incomplete state of the customs union

Of the customs union as such, it has to be acknowledged that, although more than 15 years have passed since its creation, obstacles to the free movement of goods between Member States are still being maintained by the continued application of a wide range of national procedures and formalities, which vary from one country to another. The persistence of these disparities is accounted for by the fact that the Community regulations are still incomplete and sometimes too complex or imprecise, by the cumbersomeness of the institutional decision-making machinery and by the lack of a uniform system of sanctions to deal with breaches of the Community rules.

The formation of a single market worthy of the name is being seriously hampered by the 'economic frontiers' that these three factors are allowing to subsist. The delays and costs involved in crossing these frontiers can be substantial, but the most serious aspect is the distinction between the home market and the external market that remains in the minds of managements.

Much therefore remains to be done in order to fulfil the absolutely vital requirement of making the free movement of goods a reality in practice, and not merely in law.

B — Free movement of workers

Freedom of movement for workers is the subject of a specific stipulation in the Treaty (Article 48). In practice, it is hampered by a whole range of barriers, some of a broadly psychological order, others set up by a variety of rules and regulations.

The psychological barriers — deriving from differences of language and cultural traditions — are well known. Insofar as they reflect Europe's cultural diversity, they are among the things that have to be accepted in the cause of preserving the rich heritage of our continent.

On the other hand, most of the obstacles stemming from differences between rules and regulations deserve to be removed or at least substantially lowered. The Community has taken action to deal with the most serious obstructions to freedom of movement in four main areas:

(i) *Social security cover of workers.* Originally, if a worker returned to his country of origin following a stay in another Member State, the rights acquired during that stay were not honoured. In international relations, this problem has been settled in bilateral agreements (that between France and Algeria ia an example); the Community has solved it by adopting the rule whereby migrant workers acquire and retain social-security rights on the same basis as those who remain in their country of origin.

(ii) *The right to take up paid employment.* Whereas it is generally necessary to have a work permit in order to be allowed to take a job in a foreign country, since 1968 any national of a Member State of the Community has been free to take paid employment in any other Member State (and entitled to automatic issue of residence permits, valid for five years, for himself and his family).

(iii) *Working conditions.* The principle of equality of rights of association and participation in elective bodies has been established.

(iv) *Recognition of qualifications.* Recruitement of workers is generally influenced by and sometimes conditional upon the possession of qualifications. Considerable efforts have been made to promote comparability of qualifications and recognition by each Member State of qualifications obtained in the others.

C — Free movement of capital

If a common market is to be fully operational and the marginal efficiency of capital as a factor of production is to be equal in its various possible applications, it is necessary to have free movement of capital, at least in so far as it is to be used for productive investment (the case of public borrowing is somewhat different).

The principle of freedom of movement for capital is established in the Treaty (Article 67), but is qualified by the words 'to the extent necessary to ensure the proper functioning of the common market', which are not found in the corresponding provisions on goods and workers. The use of this more guarded wording is a recognition of the multiplicity of ways in which movements of capital, as a factor of production, affect the performance of an economy. Free movement is desirable not only as a means of improving the overall efficiency of the Community's productive system, but also as a factor capable of influencing the general balance of its economy. This means that the approach to capital movements must be consistent with overall short-term economic policy; this point is taken up again in connection with economic and monetary union. Finally, intra-Community arrangements are complicated by the possibility of inconsistencies in the attitudes adopted by Member States to capital movements between themselves and third countries.

A fundamental directive, dated 11 May 1960, which is still the basis for Community action in this field, contained four lists of capital movements to be liberalized, calling for unconditional liberalization of those in lists A and B, and conditional liberalization of those in lists C and D:

List A: direct investments, personal capital movements, movements associated with trade in goods;
List B: operations in securities dealt in on stock exchanges;
List C: issues of securities on capital markets;
List D: movements of short-term capital between banks.

In fact, for reasons associated with short-term economic policy, no progress has been made over the past 20 years. However, the market has made light of the legal obstacles. In the absence of action by the public authorities to create the conditions for the formation of a genuine Community capital market, the private sector has effectively formed its own, the Eurocurrency market, whose coverage extends well beyond the boundaries of the Community; we shall return to this subject in the next chapter.

D — Freedom of establishment

A true common market can be said to exist only when nationals of any Member State are free to establish themselves in any other Member State and to set up and manage undertakings there, provided of course that they do so in accordance with the laws of the country to which they move. Provision for this is made in Article 52 of the Treaty. By the same token, there must be freedom to provide services anywhere in the Community (Article 59).

E — General assessment of the extent to which the large market has become a reality

As has been demonstrated above, the four freedoms have yet to come fully into play: some barriers to trade in goods still survive, the bulk of investment capital is still placed on domestic markets, freedom of establishment is not yet universal and, despite the virtually total disappearance of regulations obstructing movements of workers, the effects of the psychological barriers are such that there has been very little mobility over the past 15 years; the current levels of unemployment around the Community undoubtedly represent a further disincentive.

Insofar as an idea of the extent to which this large market has become a reality can be obtained from an examination of series of indicators, the following observations are significant:

(i) Intra-Community trade has risen faster than output (and slightly faster than total foreign trade in the individual Member States). Whether the volume of this trade is expressed in percentages of GDP or total exports, the trend is clear (see table below). Trade in goods on the large market is a reality confirmed not only by the statistics but also by statements from industrial leaders and the evidence of goods on display in shops throughout the Community.

(ii) Average productivity is still far from being uniform in the Community. In terms of GDP per member of working population, it can be twice as high, or more, in one country than in another. It should be pointed out, however, that the spread in levels of productivity can be almost as great between regions in the same country (where a single market is supposed to have been formed long ago). This can be found in the various countries of Europe just as much as in the United States, which is often held up as the archetype of a large market. There are therefore profound reasons for these disparities, to which we shall revert when discussing regional policy.

Intra-Community trade

	% of total exports		% of GDP		
	1958	1982	1958	1973	1982
FR of Germany	36	48	6	9	13
France	28	49	3	8	8
Italy	34	46	3	7	10
Netherlands	57	72	22	29	35
BLEU	53	71	17	35	43
United Kingdom	20	41	3	6	9
Ireland	84	71	21	25	33
Denmark	58	49	16	10	13
Greece	50	46	4	5	5
EUR 10	35	52	5	10	13

(Source: Eurostat)

(iii) Even allowing for the notorious difficulties of price comparisons between countries, the meticulous studies carried out by the Statistical Office of the European Communities give the impression that there are still substantial variations which cannot be explained purely in terms of differences in taxation or marketing methods. This suggests that producers have yet to penetrate all their potential markets and that barriers protecting national frontiers still represent a significant factor restraining exporting dynamism.

The overall impression is therefore that very substantial achievements can be claimed, but also that a variety of unjustified obstacles subsist: their elimination would open the way to greater effectiveness.

Section 2. Agricultural policy

There is an apparent paradox between the importance that all industrialized countries attribute to agricultural policy and the actual importance of farming in their national economies, measured in terms of the employment that it provides (8 million jobs out of 100 million) or its contribution to GDP (3.4% in 1978). The EEC is no exception, since agriculture is one of the few areas (along with transport and external trade) for which the Treaty stipulates a common policy. It has to be acknowledged, however, that awareness of the paradox is growing and the common agricultural policy (CAP) is attracting increasingly frequent and widespread adverse criticism.

A calm assessment of the situation will be assisted by clarification of the reasons that have led all developed countries to pursue an active agricultural policy, as a preface to a description of the CAP.

A — Why agricultural policies in developed countries?

The answers are to be found in the characteristics specific to agriculture and its products, and in history. Agriculture produces essential commodities, it is an industry dependent on climate and it provides a way of life as much as an occupation; another specific aspect is the phenomenal pace at which farming methods have developed over the past half-century. These characteristics, taken collectively, can give rise to difficulties which call for public intervention.

Since the bulk of output is intended for human consumption, agricultural products are classed as essentials, demand for which rises more slowly than personal income (or at least it does above a certain threshold which the developed countries left behind them long ago).

If, as has been the case for some 30 years, labour productivity rises in agriculture at a rate comparable to that displayed by the economy as a whole, domestic demand can be met with a decreasing agricultural work-force. This may suggest that exports should be developed. However, many of Europe's theoretical export markets are either countries which have needs but lack the means to pay for them (a large number of developing countries come into this category) or countries like the United States of America or Canada where extensive rather than intensive farming and stock-breeding methods are used and costs are lower. The opportunities for massive exports are thus blocked by the insolvency of some countries and the competitiveness of others, which could even represent a threat to some of our own markets if they are left unprotected.

The first consequence is therefore a reduction in the size of the labour force that is strictly needed in agriculture, but here it becomes necessary to take account of the second major characteristic of farming, which is — or at least was for a long time — a way of life as much as or more than just a job. Farm work, especially on small or medium-sized holdings, involves a very wide range of skills and gives great independence. Switching to employment in another industry can involve thorough vocational retraining and a big change for the family if they have to move from the country to a town. The older a farmer is, the harder it is for him to cope with such a change. Because of this situation the labour force in farming tends to remain at a higher level than necessary and the *per capita* income is relatively low, certainly below the average for the rest of the economy. There is therefore justification for action by public authorities to encourage farmers to seek alternative employment while at the same time promoting the reorganization of holdings (structure policy) and to raise the intrinsic incomes earned from farming (incomes policy).

Finally, it should be added that, with certain products in particular, the influence of the climate can make for considerable variations in the size of crops from year to year. In such circumstances it may be considered necessary for public authorities or the profession itself to take action to stabilize prices and markets (organization of markets, storage).

B — The common agricultural policy in operation

The Treaty of Rome explicitly establishes the principle of a common agricultural policy, to which it assigns the objectives of increasing productivity, ensuring a fair standard of living for farmers, stabilizing markets, assuring the availability of supplies and ensuring reasonable consumer prices (Article 39). These objectives are to be pursued simultaneously, but since some conflict with others to a certain extent, decisions have to be taken as to priorities. The Treaty is less explicit on the subject of the means to be employed, but it does mention three important aspects: market organization, pricing policy and the setting-up of a Community fund.

In view of the large numbers employed in agriculture and their relatively low incomes 20 years ago, the Community initially gave priority to the objective of raising the level of earnings from farming, which was also the main concern of most of the Member States at the time. However, in its awareness of how important it was to keep in view the long-term aim of structuring the agricultural industry in such a way that it would itself generate earnings more in line with incomes from other occupations so that the need for aid from public funds could be reduced or even eliminated, the Commission was already stressing in 1962 that it was necessary to strike a balance in simultaneously pursuing an incomes policy to deal with the immediate problems and a structural policy to lay the foundations for the solutions of the future. In fact, this balance has never been adhered to in Community policy, which has concentrated on incomes policy while structural action has largely been carried out at national level.

Incomes can be improved either by granting direct financial aid to farmers with low incomes or by raising prices. The second method was the one adopted; in fact it had been more or less in operation on the Continent, although the second had been used in the United Kingdom, where the farming population was already small. With the method chosen, the financial burden lies mainly with the consumer, whereas with subsidies the cost has to be met by the taxpayer.

When prices are maintained at a relatively high level, it is necessary to apply certain measures at the frontiers: to avoid competition from cheaper produce from third countries, charges have to be made on such produce when it enters the Community (levies); to enable farmers to export on a world market where prices are lower, it is necessary to grant them aid (refunds).

The system therefore rests on two main pillars:

(i) price guarantees for Community producers,

(ii) a system of 'locks' at frontiers to adjust price levels.

The level of prices within the Community is fixed annually, with the implicit aim of securing a certain level of income for producers on the basis of calculations that take account of their production costs and the average yields achieved with methods in general use.

Under this system, with prices fixed in units of account, there is in principle a single pricing system (adjusted for transport costs) throughout the territory of the Community and a common market in agricultural products, with farmers' incomes supported by Community preference arrangements. This support is supplemented by a financial mechanism, the European Agricultural Guidance and Guarantee Fund (EAGGF), which is part of the Community budget.

While they share the same general principles and are applied uniformly throughout the Community, the common organizations of markets differ somewhat according to the type of product:

(i) Most of them are based on intervention measures, with guaranteed prices for the main cereals, sugar, milk products, beef and veal, and more flexible measures, such as aid for storage of pigmeat, table wines and some kinds of fruit and vegetables.

(ii) In the case of about 25% of agricultural output (other fruit and vegetables, flowers, eggs and poultry), there is only protection from external competition, while prices within the Community are allowed to fluctuate freely so that supply and demand balance out.

(iii) In some cases, there are flat-rate acreage or land payments, or supplementary product subsidies.

The CAP was introduced gradually from 1964 and was fully operational in all its essentials by 1967 or so.

The EAGGF has two sections:

(i) The Guarantee Section, which finances all expenditure arising out of implementation of the common organizations of markets: interventions aimed at stabilizing the internal market (7 000 million ECU [1] in 1980, including 4 900 million on milk), export refunds (5 600 million ECU in 1980).

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[1] ECU (1. 1. 1984) = BFR/LFR 46.97; DKR 8.17; DM 2.25; DR 81.82; FF 6.89; HFL 2.53; IRL 0.72; LIT 1 372.41; UKL 0.57; USD 0.82.

(ii) The Guidance Section, which finances schemes to improve agricultural structures (approximately 600 million ECU currently).

C — The results of the common agricultural policy and changes in the nature of the problems

The CAP is the Community's principal common policy and absorbs by far the largest proportion of expenditure in its budget. It is therefore important to try to evaluate it, examining the extent to which the five objectives laid down in the Treaty have been attained.

Labour productivity in agriculture has improved strongly, rising by an average of 8.8% a year between 1961 and 1971 and at a slightly slower rate in the last decade.

Farm incomes have increased, along with other incomes (2.8% a year from 1968 to 1976), and in individual Member States they have been brought more into line with earnings in other industries. On the other hand, there are still appreciable differences between countries or regions. The CAP is responsible for both these aspects of the situation: for the first through the price maintenance policy, for the second because the machinery used to support incomes is such that it cannot take account of the existence of real, substantial differences in productivity.

The availability of supplies has been secured by protection of Community produce, with almost total self-sufficiency in most products.

Consumer prices are stable but their level remains above the world price for several products, for example wheat; however, it has to be realized that the world price is often of very limited significance and would rise sharply if the whole Community decided to reduce its degree of self-supply substantially and rely heavily on imports. Nevertheless, the level of guaranteed prices has led to lasting surpluses of some products, giving rise to heavy storage costs; the main problems are with milk products, of which there is a very large number of small producers, and sugar, the producers of which are relatively few in number and have very well organized associations. [1]

In a general retrospective review, the Commission has stated:

'The CAP has had to contend with serious difficulties: (a) the unlimited system of guarantees has led to serious imbalances between supply and demand on several major agricultural markets, milk being the biggest problem; (b) neither the price guarantees nor the refunds have made any distinction between producers and both have given more help to the richest regions

[1] It should be added that the unity of the market has been seriously disrupted by monetary instability. As a means of preventing monetary movements from causing excessive fluctuations in farmers' incomes (rising in response to a devaluation, and vice versa), corrective procedures based on monetary compensatory amounts were devised in 1971 and introduced as a temporary measure which was to be phased out. However, these procedures are still in operation and administering them is an extremely cumbersome, complex and disruptive process.

than to the least-developed regions of the Community; (c) although the financial impact of the CAP is not excessive in relation to the GDP of the Community, it has tended to increase too quickly in real terms and the manner in which funds are spent, on milk surpluses for instance, has been rightly criticized.'

Adjustments are therefore necessary, particularly in view of the fundamental changes that have occurred in the situation:

(i) Between 1960 and 1978, in the Community of Nine, the number of people having their main occupation in agriculture fell from 17.1 million to 8.1 million; although a further decline is foreseeable, the labour force is now only a little above the minimum size necessary.

(ii) The same period provided clear evidence of a developing process of concentration, with the average size of holdings of more than one hectare rising from 12 to 17.7 ha.

(iii) The second enlargement of the Community has resulted in the accession of Greece, where 30.7% of the labour force is employed in agriculture. The third enlargement will see the accession of two countries in whose economies agriculture is also a very large employer (26.8% of the labour force in Portugal and 18.3% in Spain). Agriculture in these three countries is of the Mediterranean type, with wine, fruit and vegetables accounting for a substantial proportion of output.

There is therefore reason to think that, in broad terms, less emphasis will be placed on the objective of raising incomes, which has predominated in the past, but that, in an increasingly troubled and uncertain world, more should be done to ensure reliable availability of supplies (which has hitherto been obtained as a sort of by-product of income support). In addition, special arrangements for the new Member States will probably be needed for some time.

Section 3. Industrial policy

The measures adopted to promote the formation of a large market (discussed in the first section of this chapter) are designed to provide a general framework for decision-making by companies and this in itself is enough to make them likely to affect production structures. However, practices at national level go much further in their deliberate efforts to influence the trend in structural development, which may be observed in three areas:

(i) First, the view taken of restrictive agreements and mergers (competition policy).

(ii) Secondly, specific action in favour of selected enterprises or industries, aimed in some cases at stimulating their dèvelopment and in others at assisting them to cope with the problems of adjustment or even decline. Such action generally takes the form of special tax arrangements or subsidies, but may also include publicly financed capital projects (such as development of a port to serve a large steelworks or chemical plant).

(iii) Finally, the attitude towards dealings with other countries (movements of goods and capital), in which the CCT is only one aspect — and probably no longer the most important.

In all these areas, intervention by national governments is substantial, but differs from country to country both in the stated principles underlying such action and in the choice and scope of the instruments used.

Unlike agriculture, industry and services are not the subject of a common policy laid down in the Treaty of Rome. Its provisions are more limited in this respect than those of the ECSC Treaty, being confined to laying down a policy on competition and controls over State aid. However, events have demonstrated the desirability of more extensive provisions.

A — Competition policy

Competition policy is concerned with the behaviour of enterprises and State aid.

(a) Control of restricitive agreements and mergers

In 1957 most of the Member States had policies on competition, but the procedures and strictness of controls varied widely from one country to another.

The operation of a genuinely homogeneous economic area could not have been achieved by merely allowing such diverse national practices to continue, but the differences between national laws and approaches were too great for it to be possible to replace the national rules by uniform Community regulations. The solution adopted was therefore organized coexistence of national and Community competition policies.

The EEC's rules on competition are contained in Articles 85 and 86.

Article 85 lays down the general principle of a prohibition on restrictive agreements which:
(i) are agreements between undertakings,
(ii) have as their object or effect the prevention, restriction or distortion of competition within the common market, and
(iii) may affect trade between Member States.

This article also enumerates situations in which this automatic prohibition is inapplicable.

The emergence of case-law was a very gradual process and it was not until towards 1972 that the prospect of sanctions applied by the Commission on the basis of Article 85 began to have a significant influence on the behaviour of enterprises.[1]

[1] The impact of Article 85 cannot be judged according to the number of cases in which sanctions have been applied, since its provisions are intended to be essentially dissuasive rather than punitive.

Article 86 prohibits abuses by one or more undertakings of a dominant position within the common market or in a substantial part of it, in so far as they may affect trade between Member States. Only existing abuses are sanctionable pursuant to Article 86, which therefore does not give the Community institutions powers to control the process of concentration in advance. The scope of Article 86 as an instrument of industrial policy is therefore limited, but still quite significant.

It is necessary in practice to seek a happy medium between the benefits that may be afforded by economies of scale and the disadvantages stemming from a reduction of competition, either through the abuse of dominant positions or, more subtly, through a diminution of industrial dynamism.

Taking on overall view, Article 86 has, to date at least, been used only in limited cases as an instrument for shaping productive structures in the Community. At the same time, however, its permanent presence as a sword of Damocles hanging over the heads of enterprises is undoubtedly a real influence, although impossible to evaluate accurately, preventing too many enterprises from yielding to the temptation to create dominant positions and take unfair advantage of them.

(b) Control of State aids

States all over the world support their home industry with aid, but since the purpose of this aid, which may or may not be acknowledged, is to strengthen its position against foreign competition, an economic community cannot allow its individual member countries a free hand in this regard.

Hence the presence of Article 92, which states that, which the exceptions that it lists, State aid which distorts competition is incompatible with the common market.

However, it would not have been politically realistic to apply as strict rules to the Member States as to enterprises and a door is left open in paragraph 3, which states that the following may be considered to be compatible with the common market; 'aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest' or 'aid to promote the execution of an important project of common European interest' or 'such other categories of aid as may be specified by decision of the Council'.

Thus the Treaty sets out a fairly clear principle, but at the same time mitigates its implications so as to avoid the dangers of an unduly static conception of competition.

Article 92 can only be applied with flexibility and consideration for differing circumstances. In fact, the Commission, as the Community authority, is torn between its desire to accommodate the legitimate or understandable concern of Member States not to allow the social situation in certain industries (or regions) to deteriorate and its own concern to prevent renewed compartmentalization of the common market and to ensure that uncompetitive operators are not kept in business while others manage to remain competitive without subsidies, to the detriment of the overall efficiency of Community industry. This is a classic example of how short-term national interests can clash with the Community's medium-term or long-term interests. Any solution is bound to be a compromise, but one which would be easier to work out if the ECC had a real overall industrial strategy.

But it is fair to say that, as Member States have for some years experienced increasing difficulties in balancing their budgets, the Commission can play a very valuable role in helping them to ensure that aid to enterprises goes where it is most effective.

B — The steel industry

It is worth taking a special look at developments in the steel industry. Along with coal, steel is one of the two industries with which the construction of Europe began, under a Treaty which gives the Community institutions more powers than those conferred under the Treaty of Rome. In view of its longer and deeper experience of Community integration, it is a significant case.

Steelmaking requires heavy investment (almost 1 000 ECU per tonne of annual output), with a long gestation period (5 to 8 years for a new plant) and a long life-span (20 to 25 years), and steelworks have become much larger (the 'optimum' plant capacity today is 10 million tonnes compared with 1 million tonnes 30 years ago, while overall production is 130 million tonnes in the EEC and 700 million worldwide). Since steel is a bulk product, transport (of ores, coal and coke, and finished products) is of vital importance, so that the relative fall in the cost of transport by sea has had a marked influence on the industry. Finally, steel products are largely standardized, a fact which is conducive to the existence of a real world market.

In order to take account of these characteristics, the Treaty of Paris made provision for:

(i) a measure of control over investment, through the powers given to the Commission to deliver opinions on investment projects;

(ii) a degree of market regulation, through price transparency;

(iii) some protection against external market disturbances;

(iv) control of mergers, through the compulsory requirement for prior authorization.

The legal instruments are therefore available for satisfactory public structuring of the steel market. Does the record show that they have been put to good use?

During the period of sustained economic expansion (which saw an average annual growth rate of about 5%, both in the Community market and in world demand), the market was able to function satisfactorily, despite the very sharp rise in Japanese output and exports and the emergence of new producers in the developing countries. However, the slowdown in economic progress has confronted the steel industry in the Community with serious difficulties: whereas the completion of investment programmes launched in the early 1970s brought a big increase in total capacity, demand within the Community has fallen slightly, exports to third countries have dropped sharply and imports from third countries have risen. The consequences have been a decline in capacity utilization from 87% in 1975 to below 60% and a contraction of 15% (over 100 000 workers) in the labour force between the end of 1974 and 1980.

The Commission proposed a plan (the 'Davignon plan') calling for the freezing of capacities, limitation of competition (and price-cutting) among Community producers, imposition of compulsory minimum prices for certain products, protection against dumping by third countries, negotiation of agreements with third countries under which they voluntarily limited their exports, and aid for redeployment of workers affected by structural reorganization. Some governments were for a long time reluctant to accept such a plan and it was not until the end of 1980 that it came into effect as a temporary arrangement which will, though, be applied for a fairly long period.

What was it that brought matters to this pass? Basically, inaccurate forecasts of demand trends (even with continued expansion, there would have been surplus capacity) and the Commission's inability to lend direction to the various producer's plans for expansion and to persuade all Member States to undertake necessary structural reorganization during the period of euphoria. This explains the wide differences in productivity from one country to another (man-hours per tonne of steel: United Kingdom 13; France 11; Denmark 8; BLEU, the Netherlands and Italy 7; Japan 6). The countries that had carried through reorganization programmes were accordingly reluctant to accept a plan aimed effectively at freezing the situation, albeit theoretically for a fairly short period, but in fact for an unforeseeable length of time.

These developments provide a clear illustration of how a legal framework, however well formulated, is not enough in itself to profide adequate answers to the problems of a heavy industry in a rapidly evolving world context.

C — A positive industrial policy

Although the Treaty of Rome made no provision for a positive industrial policy, the need for one quickly became apparent.

The provision of aid, on a temporary basis, to facilitate adjustment by industries in difficulties is only one aspect of industrial policy — and not the most decisive in the long term. Far greater importance is to be attached to aid granted to industries of the future, those which supply goods and services that have a vast potential market or could have a significant indirect impact on other industries or on aspects of how life in society is organized, such as for instance the development of products capable of replacing others which are already or are likely to become scarce or costly (new sources of energy) or the creation of new services (data transmission and processing).

Government intervention in such sectors may be warranted in either of two circumstances: when development needs to be stimulated, or when it needs to be controlled and channelled. For instance, where industry is proving slow for a variety of reasons (reluctance to accept risks, difficulties over raising finance, inertia, etc.) to pursue developments in certain fields which seem to offer benefits for the national or international community, 'a fillip' may be considered desirable. The 'technology assessment' approach has emerged more recently, reflecting a concern to control the rate of development, with a view to avoiding excessively damaging repercussions on existing businesses and the regions where they operate, and to take a prospective view of all potential side-effects — both beneficial and damaging — of the development of new technology. These are matters on which the Community cannot afford to remain inactive.

There are two powerful arguments in favour of a more active policy, both of them related to the size of the Community. The first is that, without a proper degree of coordination, there is reason to fear that competing projects will be mounted simultaneously in two or more Community countries, in opposition rather than cooperation with one another, thus damaging their respective chances of success (which can only be to the detriment of the Community, while the individual countries concerned stand to lose also) and the prospects for matching competition from the United States, Japan and elsewhere outside the Community.

The second argument is that, whereas some promising projects are not proceeded with because the volume of finance needed or the scale of the risk seems too much for one country to bear, the perspective is different at Community level and the costs and risks may appear quite acceptable. This applies to large projects in such fields as aerospace, offshore operations, data processing and telecommunications.

What has been done hitherto falls very far short of requirements. This is true both of preparatory studies and of operational decisions. Although important sector studies have been carried out and followed up by memoranda from the Commission to the Council, there are still no coordinated overall views on the structural developments that should be pursued in order to meet the pressures of a changing world, nor any reasoned appraisal of the priority areas for Community action.

If the situation is unsatisfactory in regard to preparatory studies, there has been a positive dearth of decisions: not one major project has been undertaken, as we shall see below, when examining the structural changes that have occurred over the past 20 years.

D — Structural changes in the Community's productive system

The results of 20 years of the Community can be assessed in terms of the development of three phenomena: specialization, cooperation between enterprises belonging to different Member States, and the launching of genuine Community projects.

There has been a very considerable trend towards specialization, although aspects of the situation are open to misinterpretation. Statistical observation taking in two or three dozen fairly large industries points to something of a reduction in specialization, since some countries have moved into various industries in which they had previously had virtually no presence, and this has led a number of over-hasty observers to claim that the common market has had no positive influence on specialization (and therefore, according to some of them at least, that is has served no useful purpose). However, a finer analysis, at a level closer to the realities of production and marketing, taking in some hundreds of products or groups of products, shows a completely different picture, with a very clear increase in specialization. Thus, while there has been a lack of specialization in the form of shifts between industries, there has been considerable specialization within industries.

It is reasonable to think that this specialization was one of the factors contributing, between 1969 and 1973, to the Community's annual average GDP growth rate of some 4.8% (4.2% per worker), thus making the Community a centre of rapid growth for 15 years.

The situation as regards cooperation between enterprises belonging to different Member States is more mixed. Links between suppliers and their customers have increased in number and scale. As mentioned in connection with competition, the number of agreements between enterprises is very large. So is the number of subsidiaries, especially sales companies, that have been formed. A vast interwoven network has thus been built up among enterprises in the Community, helping significantly to make the creation of the common market irreversible. By contrast, transfrontier mergers between enterprises are still exceptional, at least between enterprises of similar size (although there has been no lack of takeovers of small companies). The case of Agfa-Gevaert is always quoted because there are hardly any others; the mooted agreement between Fiat and Citroen, which is also rather exceptional, is an example of such a plan which came to nothing.

As for the launching of industrial projects involving enterprises from several Member States, the record is almost completely blank, apart from one major category of exceptions. Airbus and the European Space Agency have proved to be successes, but the initiative for them did not come through Community decision-making channels, although it would be absurd to use this as an argument for claiming that they are not Community ventures. But they do not constitute an example of cooperation organized through Community machinery and this should give pause. We shall return to this subject in the conclusion.

The major exception, the one example of substantial cooperation between enterprises belonging legally to Member States, has been provided by the subsidiaries of multinational parent companies from outside the Community, hitherto mostly American. The most advanced example of this is to be seen in the strategy of IBM, which has factories (and research laboratories) in several EEC countries, none of which makes the whole of any product, so that they are incapable of operating independently. In this way, the parent attacks the European market from within and gets the benefit of European research capabilities without relaxing its control over the group as a whole

Finally, there has been a discernible trend towards an ominous alternative to cooperation between Community enterprises, namely cooperation between one or more EEC enterprises and a foreign enterprise. This began with the United States of America and has been seen more recently with Japan. The motives of European enterprises entering into such arrangements are clear: if you are going to surrender part of your control over your affairs, it is best to do so with a powerful partner who can quickly give you substantial technological aid and open up a large market for you. The agreement between CII and Honeywell-Bull is an excellent example of this behaviour, that between British Leyland and Honda is another. Clearly, if such transactions became widespread, the notion of the European Community would sooner or later disappear.

The overall situation is therefore clear — and to some extent disappointing. The creation of the EEC has undoubtedly stimulated the structural reorganization and improvement of the productive system, but these improvements have been largely confined within national frontiers. Enterprises have taken only limited advantage of the opportunities made available for transfrontier regrouping or reorganization and governments have missed opportunities for developing new industries opened up by the change of dimension from the national to the Community scale. Because of these missed opportunities, we failed to do as well as we might have done during the period of economic growth, but it would be an unforgivable mistake to carry on in the same way now that we need to use every weapon at our disposal to survive against the fierce onslaught of competition from the other developed countries and the newly industrializing countries.

This is why in 1981 the Commission presented an action programme based on the idea of a preferential European industrial area or continuum, and featuring three main measures:

(i) strengthening the internal market and conducting a competition policy directed towards the effective restructuring of enterprises;

(ii) preferences with regard to public procurement;

(iii) preferences given by the Community in its own actions.

Except for the Esprit project (see below), the measures initiated are still modest, but various signs suggest that both enterprises and governments now perceive the need for Community action more clearly, particularly in response to the pressure of external competition.

Section 4. Energy policy

Energy is one of the most paradoxical aspects of the construction of Europe, which began with coal, the main source of energy at the time when the ECSC was established. Energy supplies are vital to the economies of the countries of Europe. To an outside observer, it would seem self-evident that a commom policy would be preferable to the juxtaposition of national policies. And yet the Community's achievements in this field are limited and often criticized. What is the explanation for this lack of progress?

To answer this question and take stock of the current situation, it is necessary to begin by examining the historical background, since this is a field in which the situation has been transformed radically, so that priorities have had to be changed on several occasions.

A — Developments in the general energy situation

The period from 1950 to 1980 saw two spectacular reversals of the situation.

Towards 1950 Europe was experiencing some difficulties over energy supplies, one of the main reasons for which was a shortage of foreign currency. However, the circumstances of the six original Member States varied widely: whereas the Federal Republic of Germany and Belgium were relatively rich in domestic resources, Italy had virtually none. One of the aims of the Treaty of Paris was accordingly to make German coal available throughout the Community on equal terms to all buyers. These same difficulties over securing energy supplies led to the formation of Euratom to promote a Community programme for the production of nuclear power for civilian purposes.

By about 1960 the situation had changed dramatically. With the massive output from the enormous oilfields in the Middle East, where prospecting and production costs were very low, oil was in abundant supply at negligible prices for prospection and production.

This oil not only met the rapidly increasing demand for energy, but encroached upon the territory of coal, the use of which declined in absolute as well as relative terms. All seemed well. There were admittedly those who pointed to the instability of the oil market, with production cost low in some countries (Middle East) and higher elsewhere (Venezuela, United States of America), and substantial benefits accruing to consumers through the reduction in prices. These people warned of the danger that the countries where oil was produced might take steps to secure more of the benefit for themselves. These warnings went unheeded.

The tide began to turn after 1970. First, the formation of OPEC (Organization of Petroleum Exporting Countries) brought changes in methods of calculating royalties and a number of nationalizations. The fall in energy prices was brought to a halt. Then, in three short months at the end of 1973, the price of crude rose by a factor of roughly four. For the next five years it remained more or less stable in nominal terms (or fell in real terms, given world inflation), but then shot up again (almost trebling) in 1979 and 1980.

These changes not only affected the energy field as such (modifying the structure of the energy balance and disrupting trends in other energy sources used by EEC countries), of which more later, but also had an impact on the entire economy: the low prices of the 1960s were conducive to economic growth and a bias in economic structures in favour of industries or technologies that consumed energy on a large scale; the oil crises of 1973 and 1979 exposed the dangers of these trends while at the same time making substantial inroads into each country's purchasing power through the increases in the cost of importing oil. The present stagnation in the price of oil is easing the constraints, but is unlikely to last if world economic activity takes off again.

B — Community action

The provisions on energy contained in the Treaties are less than consistent and rather brief. Where the Treaty of Paris is concerned with organizing the market in, and production of, coal, and the Euratom Treaty with development of nuclear energy, the Treaty of Rome makes no specific mention of oil or other sources of energy, which are included in its general treatment of industrial products.

The earliest measures were concerned with solving essentially internal problems (quantities and prices). The first aim was to ensure that the market in coal operated in such a way that all Member States could be supplied; hence the application of rules on the transparency of the market and the prohibition of discrimination according to the nationality of buyers. The second was to work towards harmonization of prices throughout the Community (which called for adjustments in national regulations or taxation arrangements) in order to avoid distortion of competition between energy users.

Coal-mining passed through a phase in which attitudes were favourable to the development of coal output, but subsequently, the fall in the cost of imported oil left no alternative to a rundown of the industry, organized with government subsidies in the countries concerned (Belgium, then France and later the Federal Republic of Germany) and Community funds to finance redeployment of the workers affected.

Nuclear energy is a more complex subject. From the outset, application of the Euratom Treaty was hampered by two difficulties: the imbalance between partners (in 1958 France was alone in having sizeable research resources) and the overlap between the civilian and military aspects (nuclear reactors produce plutonium, which is needed in the manufacture of atomic bombs). Moreover, the fall in the cost of oil made the harnessing of the atom for civilian applications seem less useful or less urgent.

In June 1962 an 'energy working party' drew up a 'memorandum on energy policy' which was aimed at freedom of movement for energy products in a common market and contained detailed proposals on diversification of external supplies, support for internal production of coal in particular, rapid development of nuclear energy, storage, taxation and import arrangements. This memorandum was in fact the first attempt to formulate a real energy policy for the European Community; virtually nothing came of it.

Documents produced subsequently, particularly during the period from 1968 to 1973, suffered much the same fate. The easy conditions on the world energy market were not conducive to effort.

Then came the rude awakening in the shape of the oil crisis of late 1973/early 1974. The Member States reacted — individually — by taking whatever action they considered most likely to minimize the damage to their own interests, giving a demonstration of the lack of Community unison to the rest of the world (other importing countries and exporting countries) which was tantamount to an invitation to take advantage of the situation.

The Commission attempted to meet the situation by putting forward a variety of proposals. Before examining the response to these proposals, it may be as well to consider the question of the usefulness of a Community energy policy and what it should contain.

The fundamental problem for the Community is to secure adequate, regular and reliable energy supplies at the lowest cost.

Normal action towards this end can be usefully supplemented or substituted by Community action along three main lines:

(i) through an effort in the areas of research, innovation and organization to reduce specific consumption of energy in its various uses: since the problems are similar from one country to another, some coordination of work and pooling of results (of research and experimentation) can bring benefits to all Member States at no disadvantage to any of them;

(ii) through a coordinated effort on the development of new sources of energy, another area in which it can be profitable to pool research and results;

(iii) through a common stance in international relations, since although short-term benefits are to be gained — sometimes — by individual countries using the advantages that history has handed down to them in their exclusive interests, there is every likelihood that in the medium or long term the pooling or coordinated use of all national advantages would bring better results for each and every country by increasing their bargaining power, which is a vital factor in international relations.

What has been done so far?

The first — and not inconsiderable — development to which attention can be drawn is the great progress that has been made in the exchange of information on energy, including both hard data (productive capacity, prices) and information on the policies pursued in the various Member States, which can help to reduce the risk that action taken in one country will clash with what is being done in another.

In the area of energy consumption and requirements, the Commission (in recommendations) and the Council (in a directive) have supported action taken in the various countries to promote conservation. In addition, Community funds are provided to finance aid for research.

On the production side, the Community has formulated (and periodically renews) a Community system for intervention by Member States in support of the coal-mining industry, grants financial aid for Community R&D projects on new techniques for oil and gas exploration and exploitation (200 million ECU over five years), is taking part, through its Joint Research Centre, in the development of energy generation by nuclear fusion and, through the Joint European Torus (Jet), in basic research on controlled nuclear fusion, and contributing to various research on new sources of energy (105 million ECU over four years, including energy conservation). In recent years Community finance has covered some 8% of total public expenditure on energy research in the Member States. Finally, since 1979 the Commission has had funds with which to grant partially reimbursable loans for the industrial application of new techniques.

In its dealings with the rest of the world, the Community is an active participant in very many international discussions, such as those conducted in the International Energy Agency, at Western summit meetings or in the course of the North-South Dialogue. Although such talks are beneficial in that they make for better understanding, they have as yet led to little in the way of decisions, and still less in terms of action.

The activities outlined above are not insignificant, but they amount to extraordinarily little in relation to the scale and urgency of the problem. For all the arguments in favour of a Com-

	Energy consumption in 1983		% dependence on energy imports		
	per capita (toe)	total (m toe)	1963	1973	1983
FR of Germany	4.0	276	23.7	56.5	51.2
Belgium	4.1	41	52.0	88.0	73.3
Denmark	3.2	17	96.8	99.6	86.6
France	3.2	174	53.6	79.6	61.8
Greece	1.6	16	–	–	64.9
Ireland	2.2	8	74.8	84.4	62.6
Italy	2.2	125	72.3	84.3	81.2
Luxembourg	7.7	3	99.7	99.6	98.7
Netherlands	3.3	57	67.7	22.0	7.2
United Kingdom	3.4	191	29.7	53.1	−17.4
EUR 10	3.2	876	41.6	64.3	41.9

munity approach, energy is still largely the preserve of national policies. Why should this be so?

It would be too easy — and misguided — to put all the blame on uncooperativeness on the part of governments. In fact, the situation is the result of a combination of three factors: the wide differences in circumstances from country to country, reflected in the structure of national energy balances (see table above), the close links between energy importing arrangements and foreign policy, and the slowness of decision-making in the Community. Member States see problems and their solutions differently and, fearing that the cumbersomeness of Community procedures (for which they are of course partly responsible) will seriously delay necessary action, take their own decisions separately, but without always fully appreciating that, in so doing, they spoil the chances of improving the situation for all countries in the Community.

Section 5. Research policy

Research plays a crucial role in economic, social, military and political development in our societies. Its contributions to the process of growth may be difficult to identify with any accuracy and still harder to quantify, but no one would suggest that they are not very real, and, moreover, the social and political 'spin-off' is enormous and can sometimes be — or at least seem — awesome.

A review of the worldwide research effort indicates that it breaks down in percentage terms as follows (given the statistical difficulties of comparison, the figures should be regarded as no more than very rough orders of magnitude):

USA 33%; USSR 25%; Western Europe 25%; Japan 12%, rest of the world: low.

Any interpretation of these figures should take account of the following factors:

(i) in the USSR, the research effort is not translated into innovation with the same efficiency as in the other countries;

(ii) the figure for Western Europe represents the sum of national efforts between which coordination is lacking, whereas competition and duplication are frequent.

Consequently, the relative impact of the United States of America (and Japan) on the fund of scientific and technical knowledge and the use made of it to promote economic and social development is greater than suggested by the figure quoted above, whereas that of Western Europe is smaller. The implications of this are serious, since it means that the world research effort and its applications are conditioned by the American scale of values and the economic structure of the United States of America (the influence of size, placing a premium on technologies that make for economies of scale).

Europe therefore faces a challenge and, in order to meet it, it can of course step up its research effort, but above all it needs to make better use of it. This is where the Community has a contribution to make, in four different ways: coordination between national programmes, launching cooperation projects or joint projects, disseminating scientific and technical information, and stimulating innovation.

The idea underlying the first of these four types of action is that a reduction in the number of research projects launched on the same subject can be beneficial; this does not mean eliminating all duplication, since some is necessary in such an unpredictable field, but preventing it where it is redundant. It was with this in view that the Scientific and Technical Research Committee was set up to compare notes on national public programmes.

In the absence of a Community industrial policy, it is difficult to define priorities, despite the assistance of the European Research and Development Committee. To make the best of this situation, the Commission has been endeavouring since 1980 to formulate a forward programme (FAST — Forecasting and assessment in the field of science and technology) to provide a basis for the sharing of specializations between research teams or for cooperation.

The lauching of cooperation projects is justified not only by its cost-saving potential, but also by the fact that the dimensions of the Community provide scope for operations spreading beyond national borders which are advantageous to the Community. This can hold true at one or more of the following stages: research as such, development, industrial production, and marketing (including sales to public bodies in particular). This was the thinking behind the signing of the Euratom Treaty to develop peaceful applications of nuclear energy but, as has been mentioned in the discussion of energy policy, the practical results have been very modest; the Joint Research Centre is doing good work, but on a small scale and less and less in the nuclear field, which now accounts for only 50% of its programme (safety and nuclear measurements), the other subjects of research being new sources of energy, environmental protection, operation of large plants and research in support of the Commission's sectoral activities (about 100 million ECU a year). Other fields would seem suitable for cooperation projects or joint schemes: data processing, aerospace, telecommunications, oceanography, etc. A number of operations have been launched jointly by two or more European countries: Concorde, Airbus and other aircraft, cooperation on space projects through the European Space Agency (which after several years of feeling its way, is now fully effective), and various small schemes organized in the framework of COST (European Cooperation on Scientific and Technical Research). All these operations have two things in common: they are conducted by different numbers of countries not corresponding to the membership of the Community, almost invariably outside its structures, and they are decided upon and organized independently of one another, which makes them less readily acceptable to the Member States since it is virtually impossible to arrange package deals.[1] Altogether, the Member States of the Community spend about 10% of their research funds on international cooperation (and a fifth of this on Community research).

Only very small projects of these last two types have actually come to fruition.

The impression gained from a look back over Community research policy is therefore one of procrastination and very limited concrete results. Preliminary discussions have generally proceeded with a dilatoriness wholly out of keeping with the need for rapid decisions in a continuously evolving field. Because of the constraints of budgetary systems based on annual commitments, decisions have often been called in question by one or the other party. Finally, because of the difficulties of preparing the way for industrial application of research results, efforts have been concentrated largely on fundamental research or research in the public interest.

[1] Mention should also be made of projects in the fields of coal and steel that have been financed by the Community under the terms of the ECSC Treaty.

To sum up, although it has no explicit basis in the Treaty establishing the EEC, research policy has gradually taken shape in response to demands of circumstances, but has yet to take the place in Community life that is warranted by the vital role it has to play in laying the foundations for the Europe of tomorrow.

Yet, under the pressure of necessity, things are starting to move. The Esprit project (European Strategic Programme for Research and Development in Information Technologies) provides an interesting example: on the initiative of the large European information technology companies, supported by the Commission, a substantial common research programme has been established to which funds will be allocated from the Community budget: the research will be into industrial applications, and the results can therefore be expected to make a welcome impact. It is true that one swallow does not make a summer, but perhaps our hibernation is at last coming to an end.

Chapter II — The objective of an economically homogeneous community: progress towards economic and monetary union

Over the past half-century the governments in all our countries have resorted to an ever-widening range of forms of intervention to regulate overall economic activity, their main aim being to secure full employment, price stability and economic growth, while at the same time promoting the necessary balance of payments equilibrium. This is therefore an issue which cannot be evaded at Community level. However, as will be seen later, the Treaty contains very little on the subject, and then only generalities; it has therefore been necessary to innovate in this area, in which progress by the Community is both essential and fraught with difficulties.

This chapter examines in turn the general nature of the problem, the progress made over a period of more than 10 years towards economic and monetary union (EMU), and the European Monetary System (EMS) set up in March 1979. [1]

Section 1. Macroeconomic regulation in an economic community

For a country belonging to an economic community, the circumstances in which it pursues the three fundamental objectives of full employment, stable prices and balance of payments equilibrium are no longer the same, and the need arises for a Community response.

A — Membership of the Community changes the nature of problems

The opening-up of an economy and, more especially, membership of an economic community influences the conditions under which macroeconomic policy is formulated and implemented.

(a) The opening-up of a country's economy, with the consequent increase in movements of goods, services and capital, renders it more sensitive to developments in the economies of its partners.

(b) The opening-up of an economy lessens the efficacy of various of the economic instruments at its disposal. This is true of both monetary and budgeting instruments.

To quote the Werner report on the realization by stages of economic and monetary union, 'the increasing interpenetration of the economies has entailed a weakening of autonomy for national economic policies'.

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[1] A brief account of medium-term economic planning is given in Chapter V.

(c) With different currencies being used, the exchange rate is a crucial economic variable. The fundamental question is this: how can balance of payments equilibrium be achieved?

Between two or more countries, there are just three methods of achieving balance-of-payments equilibrium:

(i) maintenance of consistent patterns of economic development in the countries concerned, particularly in regard to trends in productivity, nominal incomes and prices;

(ii) recourse to exchange rate adjustments;

(iii) capital movements.

For there to be consistency of economic development, it is essential to have at least close similarity in price movements and desirable to have comparable rates of increase in productivity.

Theoretical analysis thus leads to the following conclusions: any group of countries wishing to form a real common market, affording freedom of movement to goods, services and factors of production, must maintain stable exchange rates — or have a single currency — and they must therefore ensure real consistency in the development of their respective economies, so that their economic policies must also be consistent, which means that all countries must pursue the same objectives (although not necessarily always using the same means of attaining them).

Lastly, the Community is very much an integral part of the world trading system. In its relations with third countries, therefore, the Community economy experiences the same problems, although to a lesser degree, as those that the Member States find in their dealings with one another. But relations with the wider world are further complicated by two additional factors: the Eurodollar market, which is not subject to any controls, and the deterioration in the international monetary system.

The Euromarket has made monetary management much more difficult and complex, both nationally and internationally and one of the great imponderables of monetary policy is how the central banks, with such a mass of international liquidity lapping at their doorsteps, can maintain control of the volume of the money supply in their respective countries.

If they are to be conducted satisfactorily, international economic relations need an international currency and rules. In other words, an international monetary system is necessary. The system created at Bretton Woods in 1944 operated satisfactorily for a quarter of a century, but then gradually deteriorated and finally collapsed towards 1971. The countries of the Community therefore had to define the position of their currencies *vis-à-vis* the US dollar, deciding the exchange rate mechanism (fixed or floating rates) to be adopted and the use to be made of the US dollar or of a Community currency in their public and private intra-Community settlements.

The formation of the common market and developments in the international environment are therefore both factors reinforcing the need in the Community to make better provision for coordination between national economic policies in order to avoid the adoption of measures that are incompatible with one another, to enhance the effectiveness of measures taken at national level and to build a common strategy for relations with the rest of the world.

B — Broad outline of Community solutions that have been proposed

While the Treaty goes into great detail in its provisions on the establishment of the common market, its treatment of policy on macroeconomic regulation is couched in the most general terms. This is accounted for by a number of factors: the emphasis on considerations of productive efficiency prevailing in 1956/57, the lack of a comprehensive theory on policy on economic regulation, the differences between the policies pursued by the various countries that signed the Treaty, and the reluctance of individual Member States to surrender their sovereignty in this field. The Treaty accordingly confines itself to generalities; it requires Member States to regard their conjunctural policies as a matter of common concern (Article 103), to coordinate their economic policies (Article 105), to pursue the three main objectives (Article 104) and to treat their respective policies with regard to rates of exchange as a matter of common concern (Article 107).

However, the pressure of events made it clear that it was necessary to go further. Two documents on the subject were of fundamental importance, the Commission's memorandum of 12 February 1969 (the 'first Barre plan') and the Werner report (October 1970), which were followed up by a Council decision in February 1971.

The first Barre plan begins with a diagnosis which has lost none of its validity: 'At the Community's present stage of development, the economic policies of the Member States can no longer be considered without reference to the "Community phenomenon", which has ceased to be a marginal factor . . . For measures taken in isolation on the national level to be effective now, they must be more severe than they used to be . . . Only concerted action can prevent heavy cost (to a country adopting such measures) and damage (to the other Member States) and enable the size of the Community to be properly exploited.

The memorandum contains proposals for meeting this challenge with action along three lines:

(i) The first requirement is convergence of national medium-term strategies. The main medium-term objectives to be defined by consultation among the Member States are those concerned with the growth rates in production and employment, price trends, the current-account balance of payments and the overall balance of payments. These fundamental objectives are closely interrelated and should therefore be determined simultaneously.

(ii) Secondly, it is necessary to apply concerted short-term economic policies within the framework of these strategies. Hence the need to strengthen coordination of current economic and financial policies so that any imbalances can be apprehended in good time under the most favourable conditions for all Member States and action can be taken to rectify them with maximum effectiveness and to ensure that the policies adopted do not clash or trigger chain reactions.

(iii) Even with such consultation procedures, accidents can happen and it is therefore necessary to set up machinery for monetary cooperation within the framework of jointly defined medium-term and short-term economic policy objectives, this machinery being designed to prevent any imbalance from getting worse rather than to correct the effects of a crisis once it has erupted. A Member State in difficulties would be able to call on its partners in the Community for immediate financial support, when needed, to help it cope with its difficulties without compromising the operation of the common market.

These three themes can be found in all subsequent documents, resolutions and decisions.

The Werner report on the realization by stages of economic and monetary union in the Community incorporates an analysis of the implications of economic and monetary union by the time it reached the fully operational state.

With a fully operational economic and monetary union, it would be possible to establish an area within which people, capital, goods and services would enjoy freedom of movement, an area free from distortions of competition, without creating structural or regional imbalances as a result.

Within the monetary union currencies would be totally and irreversibly convertible, margins of fluctuation in exchange rates would be eliminated, parities would be fixed irrevocably and there would be total freedom of capital movements. National currencies might be retained, or a single Community currency introduced.

The only significant balance of payments in such a union would be the Community's overall balance with the rest of the world. By this stage, equilibrium would be maintained within the Community in the same way as within a single nation, i. e. through the influence of public-sector and private-sector transfers and mobility of the factors of production.

But it is then of crucial importance that homogeneous price trends be maintained throughout the Community. In so far as public action, whether budgetary or monetary, influences the general level of prices, steps would have to be taken to ensure that such action was fully consistent from country to country; the main conditions which would have to be fulfilled in a fully developed economic and monetary union would therefore be as follows:

(i) the creation of liquidity throughout the area, monetary policy and credit policy would be centralized;

(ii) the Community would have competence for monetary policy in relation to the rest of the world;

(iii) the Member States' policies concerning the capital market would be unified;

(iv) the essential features of public budgets as a whole, and in particular variations in their volume, the size of balances and the manner in which they are financed or used, would be decided at Community level;

(v) the Member States would no longer have exclusive control of regional and structural policies;

(vi) the two sides of industry would be consulted systematically and regularly at Community level.

Fulfilment of these conditions would necessitate major institutional reforms:

(i) the setting-up of a single decision-making centre for economic policy;

(ii) the establishment of a Community system of central banks.

It will therefore be appreciated that the economic and monetary union, once it had been brought fully into being, would be far more than a mere juxtaposition of national economies and national economic policies on which there would be periodic consultation or even a measure of coordination. A great deal of ground has to be covered before reaching the destination and this is reason enough in itself why progress towards the fully operational state can be made only gradually and will take time; in fact, the idea that it would be possible to make a great leap forward was clearly unrealistic from the outset. What, then, is the state of progress to date?

Section 2. The bumpy road towards economic and monetary union

To a large extent, the first 10 years of the construction of Europe were smiled upon by the Gods; such economic fluctuations as occurred were relatively mild and when major problems arose over employment, prices or the balance of payments, they affected only one country at a time without causing significant repercussions in the other countries, whose stability actually helped the country affected to resolve its difficulties.

Towards 1968, however, the following more or less simultaneous developments began to make their influence felt:

(i) the beginnings of an acceleration in inflation, which started from the annual rates of between 3% and 4% of earlier years to rise steadily into double figures, with wide differences from country to country;

(ii) rising unemployment, coupled with the phenomenon known as stagflation;

(iii) the start of speculative dealing on foreign exchange markets, seeking to make gains from upward or downward movements in parities; this type of speculation was favoured by the growth of the Eurodollar market, which was beginning by 1968 to become large enough to neutralize some of the instruments of economic policy and to make it difficult for central banks to take effective action in defence of their national currencies.

The first serious crisis came in France, in November 1968, and 1969 saw the devaluation of the French franc in August and the revaluation of the German mark in October.

These two events, which seriously disrupted the common market (and prompted the introduction of the monetary compensatory amounts), were met with a political reaction at the summit metting held at The Hague in December 1969.

The final communiqué included the following statements:

'They (the Heads of State or Government) have agreed that . . . a plan by stages should be drawn up by the Council during 1970 with a view to the creation of an economic and monetary union.

The development of monetary cooperation should be based on the harmonization of economic policies.

They have agreed that the possibility should be examined of setting up a European reserve fund, to which a common economic and monetary policy would lead.'

Here was official recognition of the term 'economic and monetary union', which has since become so familiar.

The Commission's document of March 1970 on the formulation of a phased plan for progress towards an economic and monetary union and the Werner report were followed up by the Council's resolution of 22 March 1971, which gave a very clear definition of the planned union in its final form, the main features being a Community economic policy and irrevocably fixed parities, and went on to enumerate the measures to be carried out during the first stage:

(i) substantial intensification of consultation and coordination in the area of short-term economic policies, including monetary and credit policy;

(ii) further harmonization of taxation;

(iii) liberalization of capital movements;

(iv) regional and structural measures;

(v) preparations for the organization of a European Monetary Cooperation Fund;

(vi) the gradual adoption of common standpoints in monetary relations with third countries and international organizations;

(vii) the holding 'from the beginning of the first stage and on an experimental basis . . . (of) exchange-rate fluctuations between the currencies of Member States within margins narrower than those resulting from the application of the margins in force for the US dollar, by means of concerted action with respect to that currency'.

Here again, internal und external measures are combined.

This resolution represented a considerable advance on the provisions of the Treaty of Rome.

When adopting the resolution, the Council recorded its agreement to the setting-up of a mechanism for medium-term financial assistance to supplement the agreement of 9 February 1970 on short-term monetary support; the resources made available for this purpose amounted to USD 2 000 million.

The lack of incident during 1970 and the scope of the March 1971 agreements seemed to augur well for the future, but the mood of confidence was to be short-lived. Two serious crises occurred during 1971.

The first alarm came in May 1971. A flood of capital speculating on a revaluation of the German mark forced the closure of the foreign exchange markets in the Federal Republic of Germany, the Netherlands, Belgium and Switzerland.

It was impossible to reach agreement on a common formula and, from 10 May, the German mark and the Dutch guilder were floated, while Belgium brought its two-tier foreign exchange market into operation. The French franc and the Italian lira remained as they were.

The second alarm, which was much more serious, came during the summer: on 15 August 1971, President Nixon announced a spectacular package of measures, including the suspension of convertibility of the US dollar (which was already inconvertible in practice).

Some degree of order was restored on 18 December 1971 by the Washington (Smithsonian Institute) Agreement which established new exchange-rate relationships in the form of central rates or parities and made arrangements for the temporary widening of margins of fluctuation to 2.25% above or below the new exchange rates.

Although this agreement brought an improvement in the situation, it was far from being the complete answer to all the Community's problems: the widening of margins of fluctuation that it allowed on a worldwide scale represented a potential threat of serious disruption to intra-Community trade,[1] there were no provisions aimed at restoring the convertibility of the US dollar and nothing had been done about regulation of the international capital market.

On 21 March 1972 the Council accordingly requested 'the central banks of the Member States, using to the full the margins of fluctuation allowed on a worldwide scale by the International Monetary Fund, to reduce by stages the difference which exists at any given time between the highest and the lowest rates of exchange of the currencies of the Member States'.

Thus the 'snake' came into existence. The reduction of margins of fluctuation between Community currencies was intended to facilitate operation of the common market. The central banks were to take concerted action to keep fluctuations between Community currencies within narrower limits than those allowed under the international agreements, in which the US dollar is the reference currency. The mechanism was therefore designed to draw the Community currencies closer together so that they could float together within the limits allowed under the Washington Agreement (the snake in the tunnel).

Sterling joined the snake.

Non-Community currencies (the Swedish krona and the Norwegian krone) also became associated from the outset, but the snake led an increasingly hazardous existence:

(i) sterling was withdrawn in June 1972, the Italian lira in February 1973, the French franc in January 1974, and the Swedish krona and Norwegian krone in 1977, so that the only currencies still in the snake at the end of 1977 were the German mark, the Dutch guilder, the Belgian franc and the Danish krone, in other words the currency of the Federal Republic of Germany accompanied by those of two countries which have particularly close trading relations with it (the Netherlands and Denmark) and another which has similar relations with one of the latter (Belgium within Benelux);

(ii) there was a succession of parity changes, one against the US dollar in February 1973 and a total of 15 within the Community over a five-year period, some of them involving only one currency, others more.

What caused this wasting away of the snake? Even in 1974 the Marjolin working group was investigating the reasons for the lack of progress; its diagnosis was strikingly simple:

'Europe is no closer to EMU than it was in 1969. In fact, if movement there has been, it has been in the wrong direction. The relatively harmonious economic and monetary grouping that was Europe during the 1960s has been coming apart in recent years; at no time during the past 25 years have national economic and monetary policies been more discordant, more divergent, than they are today.'

[1] Under the terms of these agreements, the French franc could fluctuate by $\pm$ 2.25% against the US dollar, and so could the German mark. Thus, if the French franc had fallen from its upper limit to its lower limit against the US dollar and the German mark had done the opposite at the same time, the variation in the exchange rate between the French franc and the German mark would have been 2 x 2.25 + 2 x 2.25 = 9%. This was scarcely compatible with a common market.

The lack of success was attributed to three main factors:

'Adverse events, a lack of political will, and an inadequate understanding of the nature of an economic and monetary union and of the conditions to be fulfilled if it is to come into being and be able to operate.'

The adverse events were the international monetary crisis that had continued since the late 1960s and the abrupt rise in oil prices in 1973, neither of which had been completely unforeseeable. The question of a lack of political will is discussed in the conclusion. On the third factor, the working group commented: 'It had been decided in1969 to establish an economic and monetary union over the following 10 years, without having any clear idea of what was being undertaken. At governmental level, no analysis, however rough, was made of the conditions that needed to be fulfilled. There was insufficient awareness of the essential difference between a customs union, as defined in the Treaty of Rome, and an economic and monetary union.'

These last two points explain the extremely divergent economic trends recorded in the various Member States, which had very mixed success in coping with the economic difficulties that followed in the aftermath of the raising of oil prices at the end of 1973.

Until 1972, at least in the Six, the disparities between annual rates of increase in prices had remained within tolerable bounds, even though the inflation rate was tending to become excessive. From 1973 on, however, the differences became so large as to be incompatible with exchange-rate stability: thus, over a period of five years there was a cumulative difference of approximately 25% between the Federal Republic of Germany and France and one of 17% between the Federal Republic of Germany and the Netherlands.

During these years, in fact, the problems tended increasingly to extend to a wider international context, including most of the market-economy industrialized countries (the West), and it was in this context that efforts were made to solve the most urgent problems.

During the second half of 1976, for instance, when the United Kingdom was experiencing very serious economic difficulties (a sharp slow-down in expansion, persistently high inflation, a substantial deterioration in the balance of payments, rising unemployment) and the British Government was obliged to implement drastic corrective measures, it was through the Group of Ten[1] and at the request of the IMF (under the General Arrangements to Borrow, signed in1962) that an international credit facility of SDR 3 360 million was arranged for the years 1977 and 1978 and an agreement in principle on an international guarantee of sterling balances was concluded by the central banks.

The year 1977 saw further serious deterioration in the situation:

(i) inflation was rife in the Community, running at rates that varied widely from one country to another;

(ii) unemployment was rising in all Member States;

(iii) there was no stability in exchange rates;

[1] D, B, CDN, USA, F, I, J, NL, UK, S, and subsequently CH.

(iv) there was a tendency to look outside the Community for solutions to problems, but without better success; the Eurodollar market, for instance, was still far from having been brought under control.

At the same time, the international context had also deteriorated. The Bretton Woods monetary system had run its course and nothing had really taken its place. The Jamaica agreements ratifying floating exchange rates, it was remarked only half jokingly, were something of an international monetary 'non-system'.

The situation was disturbing for the Community. In addition to the serious unemployment and inflation besetting all the Member States, there was the danger that increasing problems over operation of the common market would effectively disrupt the Community, which would in turn increase unemployment in all the Member States and add to the difficulties of many regions.

A new initiative was needed. The Commission proposed one in the Jenkins report, which stressed the simultaneous need for:

(i) stronger coordination of short-term economic policies (convergence), with standards of conduct, greater solidarity, and effective conditionality of financial assistance and

(ii) measures to complete the common market.

This initiative met with a political response. The European Council meetings in Brussels (December 1977) and Bremen (July 1978) prepared the way for the agreement of December 1978 on the European Monetary System, an important contribution to the functioning of the common market. But at the same time unemployment problems became more severe, and no solution has yet been found.

Section 3. The European Monetary System

The European Monetary System was officially adopted at the European Council in Brussels on 4 and 5 December 1978.

Two factors seem to have contributed decisively to the achievement of this agreement:

(i) the very firm political commitment displayed by the two big partners in the Community, France and the Federal Republic of Germany;

(ii) the instability of the US dollar, which was an encouragement to the European countries to adopt a more introverted attitude and at least establish a limited area of stability in a troubled world.

The system came into effect in March 1979, with sterling remaining outside for the time being (although used in defining the ECU).

A — The general principles of the system

From the technical viewpoint, the new system is the result of efforts to take account of the lessons learnt from the failures of previous attempts. Its essential features are as follows:

(i) Creation of a European currency unit, the ECU, the value and composition of which are defined in terms of a basket of Community currencies.[1] Basically the ECU is to serve as the *numéraire* for the exchange-rate mechanism, the basis for an indicator of divergence between currencies and means of settlement between Community monetary authorities.

	Fixed amount	Weighting of currencies		
		April 1975	13. 3. 1979	31. 12. 1980
DM	0.828	27.3	33.–	32.3
FF	1.15	19.5	19.9	19.4
UKL	0.0885	17.5	13.3	16.1
LIT	109.–	14.–	9.5	8.9
HFL	0.286	9.–	10.5	10.2
BFR/LFR	3.80	8.2	9.6	9.2
DKR	0.217	3.–	3.1	2.8
IRL	0.00759	1.5	1.1	1.1
		100.–	100.–	100.–

(ii) Elaboration of an exchange-rate and intervention mechanism: each currency has an ECU-related, central rate.[2] Any adjustments of the central rates are to be arranged by mutual agreement. Fluctuations around the bilateral rates deriving from the central rates are confined to ± 2.25%, except in the case of the Member States whose currencies are floating at present, which are allowed margins of fluctuation of up to 6%. The mechanism is completed by 'divergence thresholds' which are fixed at 75% of the maximum spread of divergence;[3] when a currency crosses its divergence threshold, the authorities concerned are required to take appropriate steps (various economic measures, or even adjustment of central rates).

(iii) Credit mechanisms: the existing credit mechanisms will be maintained for the initial phase of the EMS (two years) and are to be consolidated subsequently into a single fund:
- a very short-term credit facility (up to 75 days, but renewable for three months), to be established;

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[1] Initially, the value of the ECU coincided with that of the former European unit of account (EUA), but the weighting of the various currencies has changed considerably since the creation of the EUA in April 1975.

[2] The ECU is defined in relation to each currency (ECU central rate); on 13 March 1979, the ECU stood at FF 5.7983 and DM 2.51066, making the corresponding bilateral central rates: FF 1 = DM 0.433 and DM 1 = FF 2.3085.

[3] For instance, the divergence threshold for a currency with a weighting in the ECU of 20%, which is roughly that of the French franc at present, is reached when it deviates from the ECU central rate by

$$\frac{2.25 \times (100 - 20) \times 0.75}{100} = 1.35\%.$$

- short-term monetary support (14 000 million ECU);
- medium-term financial assistance (11 000 million ECU).[1]

(iv) Coordination of exchange-rate policies *vis-à-vis* the rest of the world.

B — Assessment of the system

The new system undoubtedly offers significant advantages over the snake: it demonstrates more realism, it establishes a better balance of responsibilities and it is backed by more substantial intervention resources.

The greater realism is reflected in three features, the first of which is the system's explicit acceptance of the possibility of allowing margins of fluctuation wider than the norm to countries which are experiencing economic difficulties and are therefore unable to comply with the general rule.

The explicit acceptance of the possibility of changing central rates is further evidence of profound realism. The Bretton Woods agreements showed similar realism. The snake was clearly a little over-ambitious to exclude this possibility, at least formally.

Again, the inclusion of the divergence thresholds is a practical feature, since they signal the stage at which it may be useful to initiate a joint approach to problems before they become too acute; had they been part of the snake system, the unilateral withdrawals that occurred without prior Community consultation may have been avoided.

The second major advantage of the European Monetary System is that it makes for a better sharing of responsibilities between the economy with an appreciating currency and the economy with a depreciating currency. Under the previous system, action to restore the balance had been the exclusive responsibility of countries with depreciating currencies.

The third improvement lies in the very large increase in the resources available for intervention in support of the system. With the previous system the funds available in 1973 or 1974 amounted to between 2 000 and 3 000 million dollars at a time when fluctuations in the central banks' reserves of as much as 5 000 to 6 000 million units of account were being recorded in a single day. At roughly 10 times the previous volume, the sums available for public intervention are more in line with the potential scale of speculation.

It may be added that the EMS has made a timely appearance during a period when the excessive volatility of foreign exchange markets has been causing apprehension and there has been growing disenchantment with the system of floating exchange rates which has not produced the favourable results expected of it by its advocates. Should the return to favour of fixed exchange rates prove to be lasting, both among Member States and among their main partners, it will augur very well for the EMS.

[1] To serve as a means of settlement, an initial supply of ECU was provided by the European Monetary Cooperation Fund against the deposit of 20% of the gold reserves and 20% of the US dollar reserves held by the central banks at the time of the operation. This operation took the form of revolving swap arrangements.

While the EMS has brought these considerable improvements, it still suffers from serious limitations which leave its future in doubt. Virtually no provision has been made for action to bring about the convergence of economic policies and their results. Recent years have admittedly seen considerable development of the machinery for consultation among Member States through the various Community institutions (committees and councils), but the text setting up the EMS only refers to a presumption of action and makes no specific stipulations.

In practice, the success of the system depends largely on fulfilment of the assumption that the governments which have entered into a formal undertaking to make it work will in fact do what is necessary to enable it to work, even if this means that they will have to take politically sensitive decisions involving substantial sacrifices.

Since its introduction, the EMS has worked well. A minor adjustment of central rates was carried out smoothly; the margins of fluctuation have not been exceeded. However, it remains an ambitious scheme which requires a large measure of political agreement if it is to continue to operate successfully. The key factor is not really monetary management at national level, but basically the strength of the governments' belief in the value of the common market. Are they deeply convinced that the construction of Europe is not a zero-sum game in which nobody can win unless someone else loses, but a joint venture which is capable — if only potentially as yet — of generating a surplus, so that it only remains to organize equitable methods of sharing the benefits?

There are various measures which would help to generate such a surplus, while at the same time improving the prospects for successful operation of the EMU. These are in three main areas:

(i) a dynamic structural policy, in industry in particular;

(ii) development of public transfers between Member States, but exclusively for the purposes of attaining clearly defined objectives;

(iii) formulation of really effective medium-term economic planning.

These are all fields in which too little has been achieved to date (cf. Chapter I on structural policy, Chapter V on the other two aspects).

Section 4. Crisis and the way out

It would be a good thing if Community countries experienced parallel trends, so that exchange rate stability allowed the common market to function properly. But such trends would also have to bring an improvement in the inflation and unemployment situations.

Unemployment has been deteriorating steadily for the last 15 years: initially, it tended to decrease, falling from 3.3% of the civilian labour force in 1958 to 1.9% in 1964-66; since then it has steadily climbed, slowly at first (to 2.9% in 1974), and then rapidly, to over 10% in 1983, in virtually all the member countries.

There are many reasons for the crisis, all rated differently by the experts. They include the fall-off in domestic demand for durable goods, without demand for other goods and services really taking up the running; some acceleration in technological change, making for productivity gains rather than output growth; the arrival on the labour market of the post-war 'baby bulge' (the situation will be reversed in 10 years' time); the deterioration in the international monetary system, which creates uncertainty as to the future of international economic relations; and lastly the mistakes in economic policy, in particular the increase in rigidities in the economy at a time when more adjustment is necessary and the use of classical cyclical remedies to deal with problems which are predominantly structural.

What is needed is a vigorous new drive: this has been started and inflation is coming down to more reasonable levels, but no impact has yet been made on unemployment.

Although the existence of the Community is not a panacea, a Community approach could at least help to solve the problems. The determination to make the EMS work has helped the participating countries to moderate their inflation. If employment is to fall, part of the solution lies in a revival of investment (the investment ratio has fallen from almost 23% around 1970 to under 19% today); this could be assisted both by increasing the Community (budget or loan) funds going into investment and by coordinating national investment-promoting policies so as to create a climate in which investors can take a more confident view of the future.

Chapter III — Building a community for the benefit of its people

The principle according to which improved economic performance is not an end in itself is expressed forcefully in the preamble to the Treaty of Rome, in the words 'affirming as the essential objective of their efforts the constant improvement of the living and working conditions of their peoples'.

The preamble goes on to state that the objectives assigned to the EEC are to be attained 'by reducing the differences existing between the various regions and the backwardness of the less-favoured regions'.

The aims are therefore stated unequivocally. The means are less fully expounded. There is a little in the Treaty dealing with social policy, but most of its provisions, on aims and means alike, are worded in fairly general terms; the Treaty makes no mention of regional policy. Progress in these two fields, in which incidentally priorities have evolved over the past 25 years, has therefore been a matter of gradual innovation and much remains to be done.

Section 1. Social policy

The basic premise, expressed in Article 117, is that favourable developments in the social field will be brought about both by improvement of the economic efficiency of the Community and by an internal dynamic, the effect of which will be to cause national laws and regulations to come into line gradually with those of the country where they are most favourable.

The fields in which explicit provision is made for cooperation are listed in Article 118: employment, labour law and working conditions, vocational training, social security, safety and health at work, and the right of association. Article 119 adds equality of pay for men and women.

Thus, of the four fields which undoubtedly fall within the ambit of social policy — working conditions, pay, social welfare and living conditions — only the first is fully represented in the list. However, the pressure of events has meant that increasing interest has been taken in the others.

A — Working conditions

The essential factor — the volume of employment — is closely bound up with the general economic situation and action by the Community in that area has been discussed in Chapter II.

This leaves working conditions as such, vocational training, problems associated with changes of employment, and arrangements for migrant workers.

The Community takes action in these areas either through the European Social Fund or by issuing recommendations or directives.

(a) The Social Fund has the task 'of rendering the employment of workers easier and of increasing their geographical and occupational mobility within the Community' (Article 123). The original theory was that, given the anticipated influence of the establishment of the Community in favour of specialization by companies and countries, it was necessary to create easier conditions for the associated changes of jobs between different geographical areas or industries.

In its initial form the Fund largely confined itself to the passive role of a redistribution chamber and, moreover, it operated on a modest scale (264 million u.a. altogether from 1960 to 1972).

Under a Council decision adopted on 1 February 1971, the 'new Social Fund' was set up with powers to act in two fields:

Under Article 4 of the decision, the Fund can take action when the employment situation is affected, or in danger of being affected, by Community policies or calls for action to improve the balance between supply and demand for manpower within the Community. The Fund requires the authorization of a special Council decision for any operation of this type.

The activities undertaken by the Fund under Article 5 are not specifically tied to Council decisions. They are aimed at alleviating certain kinds of employment problems in the Community, especially in backward or declining regions or in sectors of industry thrown into difficulties by technical progress. Here, the Fund's assistance is more structural in scope and the main purpose for which it is granted is the reduction of long-term unemployment and underemployment.

Finally, in addition to these forms of assistance granted unter Articles 4 and 5 the new Social Fund finances studies and projects in the field of employment out of a flexible budget.

The European Social Fund has thus become an important component in a dynamic Community policy in the field of employment, with sufficient flexibility to adapt to the priorities of the moment.

Since its reform, the bulk of its assistance has been for vocational schemes. Then, unemployment became the priority problem, hitting in particular young people (young people under 25 years of age make up 20% of the labour force and 40% of the total number of registered unemployed) and certain regions of the Community: the share of young people in the Fund's appropriations must at present be at least 75% and 40% of the Fund's resources must be allocated to six priority intervention areas.

In 1982, the Fund committed some 1 500 million ECU, from which 1 800 000 persons (including 800 000 young people) benefited.

(b) The Community has tackled other employment problems on the basis of recommendations or directives. The following will serve as examples:

(i) the formation in 1974 of the Advisory Committee on Safety, Hygiene and Health Protection at Work, whose activities are an extension of work that has been proceeding since 1952 in the coal and steel industries under the ECSC Treaty;

(ii) the adoption of directives on certain aspects of safety, and on protection against radiation under the Euratom Treaty;

(iii) guidelines on improvement of the working environment and the setting-up of the European Foundation for the Improvement of Living and Working Conditions (with headquarters in Dublin);

(iv) a directive harmonizing laws on collective redundancies;

(v) proposals to assist migrant workers, who represent a substantial proportion of the working population in several Member States.

Finally, mention should be made of the research on industrial safety, occupational diseases and ergonomics financed out of ECSC funds.

B — Pay

All countries in the Community adhere to the principle according to which the level of salaries and wages is settled by agreement between the 'social partners', i. e. management and labour. Governments intervene only in certain areas, such as when they lay down a minimum wage or set general guidelines on wage increases at certain times as part of their economic policy (this being known as incomes policy). It is therefore quite natural that the Community as such should have no involvement in wage fixing, apart from one exception.

Article 119 lays down the principle 'that men and women should receive equal pay for equal work'. This is an important issue, given the increase in the proportion of women in the total labour force, as indicated by the following percentage figures:

	1960	1975	1979
Belgium	26	35	38
Denmark	32	42	45
FR of Germany	35	38	39
France	35	38	40
Greece	....	....	30
Ireland	26	26	28
Italy	28	31	34
Luxembourg	25	28	30
Netherlands	23	28	32
United Kingdom	34	38	39
EUR 10	33	36	38

In January 1979, the Commission, while recognizing that progress had been made, expressed the view that 'the principle of equality of pay has not been fully put into practice in any of the countries of the Community, even though some have come very close and called upon the Member States to take steps to ensure that this principle was applied more fully.

Moreover, the concept of pay having been defined rather restrictively by the Court of Justice, a directive which came into force in August 1978 requires the Member States to eliminate all legal and administrative obstacles the effect of which at the work-place is that women suffer discrimination based on sex, either directly or indirectly, by reference to matrimonial or family circumstances.

C — Social welfare

In 1958 all the EEC countries already provided substantial social welfare protection (sickness insurance, family allowances, pensions, unemployment benefits, etc.), but priorities differed widely from one country to another. Was it necessary to set out to harmonize all these systems, bringing into line not only the cover of expenditure but also the scale and nature of expenditure?

The two sides of this problem, one economic and the other social, are examined here in turn.

In economic terms, the financing of social security, however it is organized, can be regarded as a component part of production costs. Depending on the basis used for the assessment of social security contributions (wages, as in France, or income tax, as it used to be in the United Kingdom), the burden may be unevenly spread among the various branches of industry, according to whether they are labour-intensive or capital-intensive.

On examination, it was found that the six original Member States' methods of financing social security were similar and that there were only small differences in their total expenditure, expressed as a percentage of GDP. There was no serious economic problem necessitating harmonization. There could have been a problem at the time of enlargement, if the United Kingdom had not decided to change its system gradually. In short, modification of the national systems was not warranted by considerations concerned with the economic operation of the Community.[1]

From the social viewpoint, the factors to be taken into account are the total amount of benefits and the proportions allocated to the various types of benefit. The proportional breakdown of benefits varied widely from one country to another, and they still do, as may be seen from the table below. Family allowances were originally much higher in France than in the Federal Republic of Germany, whereas old-age benefits accounted for a much larger proportion of the total in the Federal Republic of Germany. Was harmonization justified? The conclusion was reached that the differences stemmed from national traditions and different

[1] On the other hand, the general rise in unemployment throughout the Community is a cogent argument in favour of changing the basis on which contributions are assessed to a formula of the VAT type, which would be more neutral in its impact on the various branches of industry and would not place such a premium on mechanization of production.

assessments of priorities. Since standardization of behaviour patterns and ways of life is no part of the objectives of European integration, the problem was dealt with in a more flexible manner: no systematic harmonization, but increases where benefits appeared abnormally low in some countries compared with the others. These increases were left to the initiative of individual Member States, but the Commission helped to provide a stimulus by organizing a large-scale, comprehensive information service on what was being done in the various countries.

% breakdown of social expenditure by type of benefit

	Sickness	Industrial accidents and invalidity	Old-age	Family	Unemployment	Miscellaneous
FR of Germany	29	13	44	9	2	3
France	27	10	43	14	5	1
Italy	21	21	45	10	2	1
Netherlands	29	20	35	9	6	1
Belgium	24	11	38	13	8	6
Luxembourg	23	15	51	9	2	0
United Kingdom	25	10	46	12	5	2
Ireland	38	7	34	12	9	0
Denmark	29	11	33	11	13	3

(*Source:* Eurostat)

The trend has been towards a significant increase in the ratio of total social expenditure to GDP and greater similarity between Member States as far as the breakdown between the various types of benefit is concerned.

Finally, in view of the proportion of migrant workers in the labour force, mention should be made of the action taken to ensure that a citizen of one Member State who goes to another to work there as an employee does not lose entitlement to social benefits; this action was clearly essential in order to remove an obstacle to transfrontier mobility of labour.

D — Living conditions

If national traditions have been instrumental in shaping social security systems, their influences on the style of life in each country has clearly been even more decisive. The resultant variety, far from being undesirable, is widely considered to be one of Europe's greatest assets which it would be a very great shame to lose.

Action by the Community is therefore aimed at bringing about a general improvement in living conditions, but leaves matters of detail to the initiative of individual countries. And the list given in Article 92 of the types of State aid that are compatible with the common market begins with 'aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned'.

There are nevertheless some specific fields in which the Community has considered it appropriate to take action.

Chronologically, the first example is provided by the ECSC aid for housing to accommodate workers in the coal and steel industries, helping to finance over 150 000 dwellings (with subsidies of about one-quarter of the cost of construction).

The second, more recent, example is in the field of environmental protection. This is a problem which has become more acute (or in which more interest has been taken) over recent years, and the Community cannot disregard it:

(i) pollution knows no frontiers, being carried by air, water or the food chain;

(ii) differences in national anti-pollution regulations can amount to technical barriers to trade in the products concerned;

(iii) the introduction of standards can raise production costs, and differences in standards from one country to another affect competitive conditions;

(iv) research on anti-pollution equipment can benefit by being carried out jointly.

This is not to suggest that harmonization is necessary on all aspects of the problem, but it does mean that disparities should be examined closely to establish whether or not they are justified and compatible with the proper functioning of the common market. In addition, there are some cases in which it is easier to make progress if a problem is considered simultaneously throughout the Community.

The Council has accordingly adopted several directives aimed at preventing and reducing water pollution, combating atmospheric pollution, enforcing noise abatement, eliminating irresponsible disposal of waste, and controlling the impact of chemicals on the environment.

In addition, the Council has adopted the 'polluter pays' principle according to which it is recognized as normal that the costs of prevention and elimination should be borne by the polluter. Finally, various research programmes are financed out of Community funds.

The range of measures that have been adopted may be varied, but it is still modest and, moreover, many measures were already in course of adoption in the various Member States. Nevertheless, the Community institutions are undoubtedly playing a role as a catalyst and accelerator — a role which should be developed.

Section 2. Regional policy

Regional disparities in incomes and standards of living are common to all the Member States and they cannot be disregarded by the Community, for three reasons:

(i) they are the underlying cause of some loss of overall economic efficiency;

(ii) the various Member States all have their own regional policies, which need to be checked for compatibility;

(iii) the concept of solidarity is one of the constituents of any real community of nations and peoples.

Consequently, although the Treaty contains no specific provisions on the subject, the Community has launched a succession of operations, including the creation of the European Regional Development Fund in 1975.

A — The extent of regional disparities and their effects

Regional differences in per capita income or output exist throughout the Community: in each of the Community countries, per capita income or output in the most prosperous region is roughly twice that in the poorest region. This is the result given by a geographical subdivision into betweeen 10 and 20 regions, depending on the country (when a greater number of smaller territorial units is used, the ratio rises).

As well as these differences within countries, there is a spread in average levels from country to country, where the ratio is a little above 2 to 1. Thus, when the EEC is divided into 72 regions, the ratio between the upper and lower extremes is somewhat more than 4 to 1.

Such disparities give rise to many problems, both political and economic.

If the Community is to be worthy of its name, it clearly cannot tolerate a spread in per capita incomes of such magnitude. Whereas it is legitimate and desirable to keep up differences in ways of life, it is unacceptable for the richest regions to be indifferent to the plight of the poorest. There has to be some solidarity.

The economic problems are no less acute. First of all, low productivity in certain regions depresses the overall level of productivity in the Community. Moreover, such disparities are a spur to inflationary trends, as witness the gathering pressure from political and other sources for wages and all social benefits in the poorest regions to be aligned with those in the most prosperous regions, irrespective of differences in productivity. This trend, which has been observed in each of our countries for some time now, will be increasingly in evidence at European level as the Community progresses towards a closer economic union.

Differences in per capita output or income within the Community
(ratio of highest to lowest extremes)

EEC divided into 9 countries	1975	GDP at current exchange rates	2.9
	1975	GDP based on purchasing power parities	2.2
EEC divided into 72 regions	1970	GDP at current exchange rates	4.9
	1970	GDP based on purchasing power parities	4.4
FR of Germany	1974	GDP	1.8
France	1970	GDP	1.7
Italy	1973	GDP	2.5
United Kingdom	1974	GDP	1.6

B — The efforts made to coordinate policies

All the Member States have their own regional policies under which they endeavour to improve efficiency and raise the standard of living in regions where conditions are difficult. When such policies are formulated in isolation from one another, inefficiency and waste can result. Clearly, the need for transfrontier compatibility of transport systems (roads, railways, waterways) and telecommunications networks springs to mind in this connection. But there is more. The second type of problem arises in connection with the need to avoid costly competition when certain infrastructures of the same type (ports, motorways, etc.) are built on either side of a frontier. Thirdly, regional aid succeeds as an incentive to companies only in so far as they are unable to obtain equivalent or more substantial aid elsewhere; in other words, since it is the differential which determines the attractiveness of an incentive, there is a great tendency for countries to seek to outbid one another (particularly where two regions on either side of the same border are concerned) and such outbidding leads to increased — and often unjustified — recourse to public funds.

The first of these problems, the geographical scope of which clearly often extends beyond the Community's frontiers, has for many years been tackled in wider European forums such as the European Conference of Ministers of Transport or the International Union of Railways.

The Community does, however, provide an appropriate level at which to deal with the other two issues.

Hitherto, virtually no action has been taken on coordination of major capital spending projects.

In the case of regional aid on the other hand, the urgency of the problem was such that something had to be done. Although Article 92 recognizes that regional aid is compatible with the common market, consistency between different aid programmes still has to be established. A first step (embodied in a resolution adopted in October 1971) was taken when agreement was reached on the principle of a ceiling on aid, varying from region to region according to needs. The ceiling applies not only to aid as such but also to measures having equivalent effect, so that a limit is placed on the scope for countries to bid up incentives in competition with one another, particularly on behalf of their frontier regions.

This was only a negative measure, however. Further developments have been initiated in two other areas: comparison of national regional policies within the Regional Policy Committee and arrangements to take account of the regional impact of the gamut of other Community policies.

C — The European Regional Development Fund

The idea of a regional fund was first launched a long time ago, with backing from Italy in particular, but the decisive thrust came from the two other potential beneficiaries, the United Kingdom and Ireland. It was during the negotiations over the first enlargement of the Community that the principle of setting up such a fund was established and the European Regional Development Fund came into existence officially in March 1975.[1]

The role of the Fund was initially to supplement national aid granted to certain investment projects, although it has been expanded since. Under the original procedure, which is still in operation, applications for assistance are submitted by the governments, which have pre-selected eligible projects, so that the Fund's resources are channelled exclusively to regions that the national authorities have already included in plans for action under their own regional policies. As the map shows, these regions are southern Italy, the west and south-west of France, the whole of Ireland, western England and Scotland, and some parts of the Federal Republic of Germany, the Benelux and Denmark.

Quotas were allocated to each country when the Fund was set up.

The Fund grants assistance to two categories of investment projects:

(i) investments in industry and services which create new jobs or maintain existing employment, which in practice means the construction of a new factory or the enlargement or modernization of a production unit which is already operating; for such projects, the Fund provides assistance which can be up to 20% of the investment cost, but not more than half of the contribution from the State itself, and varies according to the number of jobs created;

(ii) infrastructure investments which are either directly linked to the development of industrial activities (the main type of investment financed hitherto) or are launched in agricultural regions facing special difficulties (mountainous regions, in decline and threatened with depopulation), examples of which include road building, electrification and water supply projects; in these cases, the Fund's contribution may be up to 30% of the investment cost.

Activities of the European Regional Development Fund (ERDF)

	National quota		Population total 1980 (000)	Population ERDF areas 1980 (000)	Grants made 1975-80		
	Original assessment	New assessment			m EUA	EUA per capita, national	EUA per capita, assist. areas
Belgium	1.49	1.39	9 854	3 237	51.02	5.18	15.76
Denmark	1.29	1.20	5 177	830	46.53	8.99	56.06
FR of Germany	6.34	6.00	61 276	22 368	273.71	4.47	12.24
France	14.87	16.86	54 905	22 065	626.89	11.42	28.41
Ireland	6.46	6.46	3 420	3 420	225.93	66.06	66.26
Italy	40.00	39.39	57 135	21 582	1 396.73	24.45	64.72
Luxembourg	0.10	0.09	364	364	3.41	9.37	9.37
Netherlands	1.69	1.58	14 127	2 283	70.50	4.99	30.88
United Kingdom	27.76	27.03	55 902	25 520	869.56	15.56	34.07
EUR 9	100	100	262 160	101 669	3 564.28	13.60	35.06

[1] Prior to this, various financial contributions had been granted for regional purposes in the form of ECSC loans, European Investment Bank loans, and payments from the European Social Fund or the Guidance Section of the EAGGF.

Under an amendment to the regulation setting up the Fund, adopted in February 1979, a non-quota section was created to intervene outside the nationally designated assisted areas, affording great flexibility for coping with unforeseen problems (the non-quota appropriation is currently limited to 5% of the Fund's resources). The national quotas were also modified slightly (to increase France's share, for the benefit of the French Overseas Departments).

The table on p. 63 shows that the activities of the Fund are in fact concentrated in a limited number of countries and regions.

The final point to be made about the Fund is that its basic philosophy centres on the pursuit of two objectives: to organize certain transfers from the richer countries to the poorer countries, and to bring about an increase in national contributions to regional development. The first of these objectives is secured by the quota system. However, it is much more difficult to ensure that Member States do not take advantage of the Fund's aid to reduce their own budgetary contributions and it is in order to avoid this contingency that the Community has begun to examine multiannual development programmes for the various regions.

Chapter IV — Efforts towards more fully developed and better organized external relations

The basis on which an economic area (a country or community) organizes its external relations depends on its general attitude towards opening up its economy to the rest of the world, but also on current economic and political conditions, and on the attitudes of the main partners.

Section 1. Background

A — The key options and the general policy of the EEC

By virtue of its membership of the European Community, a country implicitly accepts a considerable degree of openness of its economy towards the other members. However, collectively they may make up an entity which is inward looking, or alternatively which is open towards the rest of the world. This, then, is the first option to be faced.

The second option, linked to the first, is concerned with the degree to which external economic policy (commercial policy) should be a common policy.

The Treaty of Rome is very clear on both these points, immediately establishing the principles of open trading and a common policy in the preamble: 'Desiring to contribute, by means of a common commercial policy, to the progressive abolition of restrictions of international trade . . .'.

However, the overlaps between commercial policy and foreign policy in the broader sense are such that it was equally clear that there were likely to be difficulties in applying these principles.

B — A broad outline of international trade relations

The international economic environment in which the EEC has to operate has undergone profound changes since the period when the Treaty of Rome was signed.

One of the most significant features has been the widespread liberalization of commerce among the developed market-economy countries (the West). The period has seen, at least until about 1975, a much sharper volume increase in international trade than in output (elasticity of approximately 1.4), the contributory factors being the removal of quota restrictions, the reduction in customs duties, and the deliberate acceptance of an international division of labour leading to increased specialization (the process of specialization has not been seen at the level of large sectors of industry, but at a much finer level of fairly homogeneous categories of products, and has been described as intra-sector specialization, as opposed to inter-sector standardization). Despite the problems that national economies have had to contend with as a result of the slow-down in economic growth starting in 1974, the OECD countries have not merely paid lip service to the principle of open economic relations, but continued to abide by it in practice.

For many years the USSR and the European planned-economy countries (the East) adhered to the strategy of keeping trade with the 'capitalist' countries at a low level, confining their imports to products which they themselves were unable to produce (wheat) or manufacture (advanced technology) in sufficient quantity.The past 10 years have seen a shift in this strategy towards a considerably more open approach, reflected in a quite sharp expansion of trade (in which Eastern Europe's imports have in fact risen at a faster rate than its exports).

The coinage of new terms — North-South Dialogue, new international economic order — is an indicator of the greater importance assumed by relations between developed countries (West and East) and developing countries. Moreover, as the developing countries have gradually become aware of their identity and their numbers have increased (the 'Group of 77' now has more than 100 members), so they have begun to have less and less in common: on the one hand, since 1973 the OPEC members have enjoyed very substantial currency revenues from the sale of oil, the price of which has risen from below USD 3 per barrel in June of that year to about USD 12 by early 1974 and some USD 35 by the end of 1980 (while prices in general roughly doubled); on the other hand, there is an extraordinarily wide spread in growth rates from one country to another (from 1% to 10% per capita) and 'newly-industrializing countries' (South Korea, Taiwan, Hong Kong, Singapore, Mexico, Brazil, Israel) have been emerging.

Two final significant features have been the sharp increase in Europe's dependence on external energy supplies and the rise to pre-eminence of the multinationals.

In the midst of this changing environment, a number of situations have caused serious problems: the heavy indebtedness of the East European countries, the crushing debt burden of the developing countries and the instability of world energy supplies.

As a result of the combined effect of these various factors, the current situation is unstable. In particular, there is widespread pressure for a reversion to protectionism, the internationalization of capital is provoking both political and social objections, inflation throughout the world (including Eastern Europe) is confounding economic calculations and disrupting trade procedures, and all the instability of political relations is spilling over into economic relations, so closely interwoven are they. The cold war of the 1950s may have been followed by *détente* during the 1960s and early 1970s, but the evidence shows some deterioration currently.

C — The Community's trade

The Community countries' total external trade represents some 40% of world trade and almost 30% of Community GDP. This percentage is much higher than the one 25 years ago (19% in 1958).

The pattern shows a roughly equal divide between intra-Community trade and trade with third countries. Here, too, the trend is quite clear, since intra-Community trade accounted for only a third of the total at the time when the common market was formed.

Today's trade with the various groups of partners among third countries breaks down as follows:

(i) almost half of exports and imports with the other OECD countries (the other European members, the United States of America and Japan);

(ii) under 10% with Eastern Europe;

(iii) about one-fifth with the non-oil-producing developing countries;

(iv) almost a fifth of exports and almost a quarter of imports with OPEC.

The Community's main trading partners %

	Exports	Imports
Total		
Intra-EEC	52	49
Extra-EEC	48	51
	100	100
Extra-EEC		
Other OECD Europe	29	22
USA	15	17
Japan	2	5
Other OECD	3	3
OPEC	19	23
Developing countries	21	18
Planned-economy countries	7	9
Rest of the world	4	3
	100	100

Section 2. Relations with the industrialized countries

A distinction is made between the general pattern (which is valid for relations with the United States of America and Japan, among others), the special arrangements for the EFTA countries, and the very special case of relations with the planned-economy countries.

A — Organization of trade relations among developed market-economy countries

The main instrument regulating the EEC's relations with industrialized countries is the General Agreement onTariffs and Trade (GATT), which aims to organize world trade on the most open basis possible, with the abolition of quota restrictions (completed between industrialized countries before 1960), the reduction of customs duties and the lowering of non-tariff barriers to trade.[1]

The first step taken by the Community was to formulate the Common Customs Tariff (CCT), basing the duties on the average of the rates charged formerly by the Member States. This CCT came into force at the end of the transitional period, on 1 July 1968.

During the period since 1960 the developed market-economy countries have collectively demonstrated their determination to promote international trade. A first series of negotiations, the Dillon Round, led to reductions in various customs duties. This was followed by the much more comprehensive Kennedy Round (in which the Community spoke with a single voice), during the course of which substantial reductions in customs duties were agreed.

The third major round of negotiations, the Tokyo Round, was concerned with 'non-tariff' barriers to trade (customs valuation procedures, preferential award of public contracts, etc.). The results achieved were:

(i) a further general reduction of about one-third in the tariffs of the principal trading partners (EEC, USA, Japan), to be phased over the eight years to 1987, together with smoothing of the highest 'peaks';

(ii) improvements affecting agricultural trade, and acceptance of the specific mechanisms of the CAP (which the USA in particular had contested for many years);

(iii) signature of a series of codes aimed at improving discipline, covering customs valuation, technical barriers to trade, government purchasing, subsidies and countervailing duties, and finally measures to combat dumping.

Experience alone will show the practical value of all these agreements. It is nevertheless worth stressing that, despite all the pressures, temptations to revert to protectionism have so far been resisted.

Thus, although trade among the industrialized market-economy countries is now taking place in a context of lower customs duties, surviving non-tariff barriers (used to full advantage by various countries) will take a long and gradual process to dismantle.

In particular, the Community tariff is now very low, under 5% as an arithmetic mean. The Community tariff is also relatively uniform; bearing in mind that the degree of protection afforded by customs duties depends on the extent to which they differ from the average rate, it will be appreciated that the Community now enjoys little protection from imports, and much less than its leading partners (United States of America, Japan), whose tariffs show a much wider range of rates.

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[1] The GATT rules expressly allow the creation of common markets.

Finally, mention should be made of the increasingly prominent role played in trade by the multinationals, which have production units in several countries and generally operate on the basis of some form of specialization, allocating different functions to their various factories. This approach sets up trade flows between factories belonging to the same multinational parent which are somewhat different from the conventional pattern of trade flows between buyers and sellers having no organic relationship. It would have been logical for our governments and the Community institutions to have responded to this development, and more particularly to have laid down new rules. There has been no such action so far.

B — Special relations with EFTA

When the Six established the EEC in 1957, the United Kingdom decided to counter the move by creating, in parallel with the EEC, a free trade area[1] with six other European countries: Austria, Denmark, Norway, Portugal, Sweden and Switzerland.

In 1973, when the Community was enlarged on the first occasion, the United Kingdom and Denmark transferred from EFTA to the EEC. The volume of trade between these two countries and the other EFTA members was such that it was virtually impossible to restore customs barriers between the two groups of countries. The logic of the common market demanded that the opposite course be taken by abolishing customs barriers between the original members of the EEC and the remaining EFTA members.

A free trade area was accordingly created between the enlarged EEC and the remaining members of the European Free Trade Association (including Portugal, also destined to switch from EFTA to the EEC eventually). In this area, with its market of more than 300 million consumers, customs duties and restrictions on industrial trade have been abolished; moreover, by dint of relaxation of the common agricultural policy, mutual concessions have been granted on agricultural products.

C — Relations with the planned-economy countries

Relations with the developed planned-economy countries (The USSR and East European countries) are influenced by two essential facts, the first being that, in these countries, foreign trade is State trade and relations are conducted at State level, and the second that these countries are not members of GATT.

In such a context, application of the Community principle of a common commercial policy is both essential and extremely difficult. Attempts to make progress have been made on several fronts: implementation of a common commercial policy, coordination of cooperation agreements, and establishment of relations with Comecon (Council for Mutual Economic Assistance), the economic association of the East European States.

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[1] A free trade area is an area in which there are no customs duties or tariff barriers between member countries, but which differs from a common market in that each member country keeps its own customs tariff for the rest of the world.

Since 1 January 1975 the rule has been that all commercial negotiations with the State-trading countries must be conducted by the Community. However, pending the negotiation of trade agreements between the Community and the various State-trading countries,[1] the Council is adopting unilateral arrangements for imports from these countries so as to maintain continuity of trade with them.

In the tariff area, the Commission is anxious not to compromise the development of trade and is continuing to apply most-favoured-nation treatment, with the usual exceptions, to the State-trading countries.

In another move, the Council decided in 1974 to set up a procedure for information and consultation on Member States' cooperation agreements with third countries in general and the various East European countries in particular. The purpose of this procedure is threefold: to ensure that cooperation agreements are consistent with common policies, especially the common commercial policy, to improve the exchange of information and the coordination of Member States' actions, and to assess the desirability of measures that the Community is considering with a view to promoting cooperation projects.

Finally, there was an apparent logic in attempting to establish relations between the two associations whose memberships are made up of the countries of Western and Eastern Europe respectively. Exploratory talks began in February 1975 and have been continuing year by year ever since, but without as yet leading to any concrete conclusion.

Section 3. Relations with the developing countries

The basic options regarding relations with the developing countries are as follows:

(i) whether to adopt a neutral attitude towards them or to pursue a policy deliberately geared to their development plans (an option which determines the nature of these relations);

(ii) whether to adopt the same attitude towards all developing countries or to concentrate on relations with some of them (generality or specificity of relations).

The choices between these options depend fundamentally on political considerations, but they are also influenced by the economic factors outlined above.

A — General

The Treaty of Rome deals with the basic principles in very general terms: 'Intending to confirm the solidarity which binds Europe and the overseas countries and desiring to ensure the development of their prosperity . . .' (preamble). Article 3, which enumerates the activities of the Community, includes: 'the association of the overseas countries and territories in order to increase trade and to promote jointly economic and social development'.

[1] Negotiations covering all industrial products were conducted with Romania.

We therefore find both a general declaration of solidarity and a statement of the intention to make exceptional arrangements for non-European countries and territories with which Member States have special relations of historical origin, which in practice means relations dating back to the colonial past.

It is immediately apparent that attempts to translate these principles into practice were likely to run into problems of incompatibility and cause resentment among one or other group of developing countries. If the Community concentrated heavily on its special relations with certain countries (basically in Africa), countries on other continents, especially Latin America where there is a strong tradition of trade with Europe, would consider themselves the victims of discrimination. On the other hand, if it tended to show the same degree of openness in its attitude to all developing countries, the associated countries would consider that association was devoid of meaning. Over the past 25 years, both situations have arisen.

As regards the nature of relations with the developing countries, the general principle of solidarity calls for a positive contribution to their economic development, which can take any of the following forms:

(i) the opening-up of markets to products (both agricultural and industrial) from the developing countries;

(ii) stabilization of the developing countries' export earnings;

(iii) support for specific projects (financial aid, technological assistance, training).

The need to reconcile special recognition for historical ties with the wish to maintain an overall development aid programme, the real differences in economic and political conditions in the various developing countries and reactions from certain interest groups within the Community to the opening-up of its internal markets to certain products from the developing countries are so many factors which have led the Community, in its relations with the Third World, to enter into a series of operations which pose problems of consistency.

B — Relations with the associated States

(a) The spirit of the Treaty

Article 132 of the Treaty of Rome laid down arrangements for association of these countries with the Community with the following fundamental objectives in view:

(i) equality of treatment for trade between Member States and associated countries with trade among Member States;

(ii) contributions by Member States to the 'investments required for the progressive development' of the associated countries.

The Treaty laid down that customs duties on imports from the associated countries were to be abolished progressively in line with the abolition of duties between Member States. It also called for reciprocal abolition of duties, but with the possibility of delaying the timetable. The financial aid was to be provided through the European Development Fund (EDF).

Initial arrangements for association were made (the actual amount of the first fund was stipulated in the Treaty of Rome). Article 136 specified that they would be re-examined before the end of the first five-year period.

However, by the end of this period, the associated countries had become independent States, so that negotiations were held to determine the basis for renewing the association procedure.

(b) Successive conventions

A first convention was signed at Yaoundé (Cameroon) on 20 July 1963 between the EEC and 17 Associated African States and Madagascar (AASM).

This Convention carried forward the previous arrangements, but lowered the external tariff on tropical products and, most significantly, set up a joint (EEC-AASM) institutional structure to apply the provisions of the agreement.

A second convention was signed on 29 July 1969, again at Yaoundé. The aid from the EDF and the EIB, as well as being increased in volume, was to be granted on more flexible conditions and channelled to a greater extent into productive sectors. In addition, a special reserve fund was set up to intervene on a case-by-case basis when there was a substantial fall in the world price of a product which was of vital importance to the economy of an associated State; this marked the beginnings of practical action aimed at attaining the objective of stabilizing the associated States' export earnings.

One of the problems posed by the enlargement of the Community was the potentially substantial increase in the number of associated States and it therefore prompted a searching review of the content of the agreements.

The Convention signed at Lomé (Togo) on 28 February 1975 with 46 African, Caribbean and Pacific States (ACP) brought progress in four main areas:

(i) On the one hand, trade cooperation and the principle of non-reciprocity were established. On the other, the general rule was free access to the Community market for ACP products, apart from a few products covered by the common agricultural policy: altogether, 99.2% of imports from the ACP States now had completely free access.

(ii) Stabilization of export earnings (cf. details of Stabex below).

(iii) Financial cooperation, the total amount of which was raised to 3 390 million u. a.

(iv) Industrial cooperation. In addition to the established machinery of financial aid, the Convention contained a series of provisions concerned with the development of infrastructures, the formation of manufacturing enterprises, especially to process raw materials, access to technology, and the setting-up of structures for information, advisory services and sales promotion. Thus an open framework was created and placed at the disposal of the Community's various partners so that they could take advantage of it gradually, on their own initiative.

The most recent convention (Lomé II) was signed on 31 October 1979 between the then nine Member States of the EEC and 57 ACP States.[1] The main innovations, less dramatic on this occasion, were:

(i) the introduction of a chapter for agricultural cooperation (with a stipulation that 40% of EDF funds were to be allocated to rural development);

(ii) the raising of the number of agricultural products covered by Stabex to 44;

(iii) the creation of Sysmin, a mechanism similar to Stabex, covering mining products and designed to safeguard mining potential in the ACP States.

The next convention, due to be signed in 1984, is now in preparation.

(c) The Stabex mechanism and developments from it

One of the major obstacles to the economic development of countries in the Third World is the instability of their export earnings, on which they rely for resources with which to pay for the capital goods that they have to import.

The developing countries have repeatedly pointed out that it is impossible for them to pursue realistic medium-term development plans in the absence of mechanisms guaranteeing them a steadier flow of export earnings and protecting them against the sharp falls in prices which occur in certain years.

Stabex is the first large-scale international attempt to tackle this problem and lay the foundations for a solution.

The basic principle of the mechanism is simple: if the value of an ACP State's exports of a product classed as being important to its economy shows a percentage fall below a certain threshold compared with their value during a reference period, stabilizing transfers will be made to offset the fall in earnings.

The products concerned are agricultural products (of which 29 were listed in Lomé I and 44 in Lomé II). The reference level is the average value of exports over the previous four years (and therefore a moving average). The threshold triggering a transfer is normally 7.5%, but only 2.5% in the case of the least-developed countries, landlocked or island States. The stabilizing transfers are drawn from a chapter of the EDF specially created for the purpose, the resources of which are replenished by repayments made by recipient States during the years following that in which they draw on the Fund, assuming that their earnings recover sufficiently; the least-developed countries are not required to make repayments.

Stabex has often been described as a substantial contribution to the development of the ACP countries and put forward as a possible model for all North-South relations. It is most certain-

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[1] The number of ACP States has since risen to 63. The combined population of the countries that are party to the Convention is therefore in excess of 500 million people, with a roughly even split between the EEC and the ACP countries.

ly a useful means of counteracting the effects of aleatory falls in export earnings, but its limitations must be recognized:

(i) first, it is designed to deal with temporary falls, but not with lasting falls caused by such factors as competition from substitutable products; it would therefore be mistaken to describe it as a mechanism capable of bringing about a lasting improvement — or even stabilization — in the terms of trade;

(ii) secondly, in its present form as organized by Lomé I and carried forward under Lomé II, it operates on the basis of nominal values; with world inflation, the real falls in earnings have to be much larger than those shown by the nominal figures in order to qualify;

(iii) finally, under Lomé I, it applied to only a limited range of products, not including mining products.

This third limitation was alleviated under Lomé II by the introduction of an 'accident insurance' system, Sysmin, for ore-exporting ACP countries designed to safeguard their mining potential (in the mutual interest of the countries concerned and the EEC). If a country's capacity for production or for export to the EEC of an ore having in the past accounted for at least 15% (10%) of its total exports is in danger of being reduced by more than 10%, such an 'accident' entitles the country concerned to obtain a financial contribution (loans at 1% interest redeemable over 40 years) towards the cost of projects aimed at maintaining or restoring the capacity affected.

(d) The European Development Fund (EDF)

The EDF draws its resources from the Member States of the EEC (the Fund is now an integral part of the Community budget, although this was not the case originally) and its role is to finance projects in the associated States.

At first it confined itself to capital expenditure projects, mainly for the development of infrastructures, whether predominantly economic (roads, ports, etc.) or social (hospitals, schools, etc.). Since the Lomé Conventions, the Fund has also helped to finance industrial or agricultural projects.

C — Relations with other developing countries

One of the basic priorities for all developing countries in their relations with the industrialized countries is to be able to export the manufactured goods that they produce under the best possible economic conditions. However, their manufactures are often fairly traditional goods, demand for which is rising only slowly in the industrialized countries, and moreover they tend to be goods with a high labour content. Consequently, any increase in imports of such goods by the industrialized countries brings competitive pressure to bear on established domestic manufacturers, and this precisely in industries which provide a great deal of employment and often play a key role in the economy of various regions; the textile industry is the best example of this, but not the only one.

Thus, the purposes of the two groups of partners are diametrically opposed and this explains why it took some time to reach some basis of an agreement.

(a) The generalized system of preferences

It was in 1968, during the second session of Unctad, that agreement in principle emerged on the component parts of a 'generalized system of preferences' (GSP), consisting of customs franchise privileges for certain imported products. These tariff preferences are: granted and not negotiated; generalized (granted in theory by most industrialized countries); non-discriminatory (granted to all developing countries without distinction); and non-reciprocal.

Once the framework of a general system had been provided, individual countries arranged their own schemes. The Community's scheme came into effect on 1 July 1971 and was the first, the others following over the subsequent five years.

In the case of industrial products, the principle is therefore that imports enter the EEC free of customs duties; however, this principle is substantially qualified by the fact that it is applicable only within the limits of certain amounts (ceilings or quotas), and the more sensitive the product the stricter the limits. In the case of non-sensitive products, duties can be reimposed once the ceiling has been reached, by decision of the Commission. With highly sensitive products, duties are reimposed automatically once the limits have been reached.

The volume of industrial goods entering the market duty-free has risen from year to year, reaching approximately 6 900 million ECU by 1980. The growth rate was very rapid during the first years (1 000 million units of account in 1972, 5 000 million in 1977), but has since slowed down to little more than the rate of increase in prices. This slowdown is an indication of the worry in the EEC countries in the face of competition from many developing countries, especially those referred to as the newly-industrializing countries (NICs).

The amount for agricultural products is very much lower (1 300 million ECU in 1980).

(b) The Multi-Fibre Arrangement

The textile industry is in the very front rank of sensitive sectors and efforts to promote orderly development of trade while at the same time avoiding disruption of the market in the importing industrialized countries go back many years. They began with the Long-term Arrangement regarding International Trade in Cotton Textiles signed in 1962. This was replaced in 1974 by the Multi-Fibre Arrangement, signed under the auspices of GATT, which owed its name to the fact that it covered the majority of textiles (man-made and synthetic as well as cotton and wool). Under this Arrangement, the signatories undertook not to introduce any new unilateral or bilateral restrictions on trade in textiles, and even to undertake the gradual elimination of existing quantitative restrictions, except in cases specified in the Arrangement, which explicitly allowed safeguard provisions (Article 3) and the possibility of negotiating bilateral agreements (Article 4).

It is the latter article that the Community has used as the foundation of its policy on textiles, concluding bilateral agreements based essentially on the principle of acceptance by the supplier countries of voluntary restraint on exports of a limited number of products, with a gradual increase in the quantities allowed. Such agreements have been signed with most of the East Asian countries and several countries in Latin America.

(c) Other agreements

As well as the specialized agreements covering trade in textiles (see above) or manufactured products signed with many countries, the Community has concluded non-preferential trade agreements with, among others, Argentina, Brazil, Mexico, Uruguay, Bangladesh, India, Pakistan and Sri Lanka.

These agreements, which are intended to facilitate trade in certain goods, are in fact fairly limited in scope and often fall far short of the wishes of our partners. Several countries in Latin America in particular had hoped that they would be able to build up close relations with Europe, which would have put them in a position to reduce the dominance (and sometimes domineering) that they experience in their relations with their North American partner.

(d) Relations with the Mediterranean countries

Even without going back to the days of the '*mare nostrum*' of the Romans, several of the present Member States have a long tradition of close cultural or economic ties with the various riparian States of the Mediterranean. It was therefore understandable that the EEC should have been concerned to organize its relations with these States on a consistent basis and therefore to address itself to the task of formulating a 'Mediterranean policy'. It therefore proceeded, on a fuller basis and at an earlier stage than with the rest of the world, to sign agreements of various types with almost all the Mediterranean countries.

A first group of agreements was concluded with countries which, *a priori,* were candidates for accession to the Community. These began with the association agreements, establishing a customs union and envisaging accession, which were signed with Greece in 1962 and with Turkey in1964. Greece applied officially to join in 1975 and the Accession Treaty was signed in 1979 and came into force on 1 January 1981.

With Spain and Portugal, preferential trade agreements aimed at the creation of a free trade area were signed in 1970 and 1973 respectively.

Both countries submitted official applications for accession in 1977 and negotiations are proceeding.

In 1976 and 1977 agreements on commercial, industrial, technical, social and financial cooperation, which included provisions on free access for industrial goods to the Community market and preferences for agricultural products, were signed with Algeria, Morocco, Tunisia, Egypt, Jordan, Lebanon and Syria. Trade arrangements have been in force since 1 July 1976 with the first three of these countries, and since 1 January 1977 with the others; their actual scope varies quite considerably from one country to another.

To complete the list, an agreement establishing a free trade area and cooperation with Israel was signed in 1975, a non-preferential trade agreement was signed with Yugoslavia in 1973, and there are association agreements with Cyprus and Malta aimed at the gradual creation of customs union.

Libya and Albania are the only Mediterranean countries not to have signed agreements of one kind or another.

Chapter V — The instruments for efficient operation of the Community: institutions, budget, medium-term programme

If it is to achieve the ambitious goals that it has set itself, the Community must have instruments that are efficient and well-suited to their purpose. It needs:

(i) decision-making machinery providing a framework in which problems can be approached from a Community viewpoint, solutions with a proper balance between Community and national considerations can be proposed, and decisions can be taken with sufficient speed for timely action to be taken to deal with the problems that arise in a rapidly changing environment;

(ii) budget resources, without which nothing concrete can be achieved, both to carry out cooperation projects of joint schemes and to demonstrate solidarity among partners;

(iii) an overall medium-term and long-term strategy, taking a sufficiently long view and taking account of the need for consistency between all policies, which can be translated into practical terms in the form of a medium-term economic programme.

The Treaty contains a patchy supply of such instruments, but, in the course of its life, the Community has modified its provisions for practical purposes, either by making additions or conversely by reducing the scope of certain stipulations.

Section 1. The decision-making machinery

The Community's decision-making machinery is designed to strike a working balance between two priorities which can be contradictory in some cases, one being to take account of the interests of the Community as a whole at all times and the other to respect the legitimate aspirations of the various Member States. The Community exists for its members and care has to be taken to ensure, on the one hand, that its dynamic does not create serious disruption in any one country at any stage and, on the other, that resistance by any one country does not impede its progress.

The Treaty had therefore provided for an original institutional structure resting on two mainstays: a decision-making diarchy and majority voting. In a word, the Commission would propose and, except in a few fields in which it had direct competence, the Council of Ministers would decide (where appropriate, having consulted the European Parliament); there would thus be one institution whose fundamental role was to think in Community terms and stimulate the development of the Community as necessary and another to take the political decisions reconciling the Community interest and the interests of the various Member States; the principle of majority voting (on a simple or qualified majority, depending on the subject) would be a safeguard againt abuse of the veto, which has reduced various international organizations to impotence. Finally, the role of general political watchdog would be played by the European Parliament, whose members were to be elected by direct suffrage. [1]

Over the years, however, competence came to be shared on a somewhat different basis, as a result of which the decision-making process became extremely cumbersome and slow. Whereas the authors of the Treaty had intended the Council to concentrate on the great issues (laying down broad policy and taking the big decisions), it formed the increasingly firm habit of taking an interest in all matters, whether large or small, and having all the Commission's proposals re-examined by its offshoot, the Permanent Representatives Committee. The decision-making process became more and more protracted. It therefore became necessary to create an additional decision-making body, the European Council, which meets three times a year but has also tended to get bogged down.

Before the time came for it to be put into practice (at the end of the transitional period in 1967), the principle of majority voting was abandoned. The 'Luxembourg compromise' seriously undermined the spirit of the institutional machinery by maintaining the right of veto, which leaves the door wide open to all manner of political horse-trading, even on minor matters.

Finally, although called for in the Treaty, elections of Members of the European Parliament by direct universal suffrage were not held until 1979, 20 years into the life of the EEC. An attempt to establish a new institutional balance is therefore currently in progress.

The Court of Justice is alone in having functioned consistently in accordance with the Treaty from the outset.

While the Community decision-making process was becoming increasingly unwieldy and slow-moving, the problems to be tackled were becoming more and more complex. It was at the end of the transitional period, just when the Community should have been pressing ahead boldly with coordinated or common policies, that the difficulties of making such progress were heightened by the revocation of the principle of majority decision. As the international context has become increasingly uncertain and disturbing, the time-scales for the preparation and adoption of decisions have become longer and longer.

So far, all proposals for streamlining decision-making in the EEC have come to nothing. This is a serious weakness, which is preventing the Community from assuming the role in the world which it could and should be playing.

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[1] To avoid misunderstanding, attention is drawn to the differences between the powers of national parliaments and those of the European Parliament. National parliaments enact legislation, vote on annual budgets, and approve or disapprove of the government in office. In the Community, the equivalent of legislative power lies with the Council, budgetary power is shared, and the Parliament can censure the Commission, but not the Council.

Section 2. The Community budget

In order to function efficiently, any policy-making organization, particularly if it has economic responsibilities, must have the necessary financial resources, in other words a budget which not only covers administrative costs, but also provides appropriations for operational activities. Otherwise, its role will be confined to research and advisory functions. The European Community is no exception to this rule and the various treaties make specific provision for such budgets.

The original text was supplemented by a Council decision on the replacement of financial contributions from Member States by the Communities' own resources which was adopted on 21 April 1970 and a Treaty signed on 22 April 1970 which, *inter alia,* made changes in the procedures for the preparation and adoption of the budget, strengthening the role of the Parliament.

A — Expenditure

The Community budget, like any other, is a fairly good indicator of the activities pursued and of their relative importance.

Two figures will serve to put the size of the budget in perspective: Community expenditure accounts for approximately 2.5% of the Member States' total public spending and corresponds to roughly 0.8% of their collective GDP. These percentages have displayed a slight upward trend over recent years.

The operational budget has reached its present form as a result of a series of developments. During the early years the level of expenditure was very low. It was in the second half of the 1960s, as financing of the common agricultural policy got under way, that a full-scale 'expenditure explosion' occurred (103 million units of account in 1965, 537 million in 1966, 2 044 million in 1967). Subsequent years saw the expansion of the Social Fund and the establishment of the Regional Fund. Both the scale and the structure of expenditure have therefore changed quite radically over the past 20 years.

Administrative expenditure, which includes the salaries of the Commission's staff of 11 000 and the other institutions' 5 000 employees, accounts for about 4% of the overall budget. The heading 'refunds to Member States' corresponds to a flat-rate payment (10%) to cover expenditure incurred by the national authorities in collecting the resources contributed to the Community budget.

Of the strictly operational expenditure, the EAGGF absorbs the vast bulk; despite a succession of declarations on the need to reduce its share, it still accounts for about 70% of total expenditure, and of this the Guarantee Section takes over nine-tenths.

The share allocated to the Social Fund has increased a little, especially since the Fund was reformed (cf. Chapter III), but remains very small.

The Regional Fund fares quite well, bearing in mind that it came into existence only recently.

The heading 'development cooperation' represents only a proportion of the funds allocated for this purpose, since the EDF is not included in the budget.

Finally, the reader will notice the very low level, both in absolute terms and as a proportion of the budget, of resources allocated to industry, energy, research and transport. This reflects the virtual non-existence of Community policies in these fields, to which reference was made in Chapter I.

Percentage breakdown of appropriations for payment in the 1984 budget

Agricultural sector	70	Energy, research, industry, transport	5
of which: EAGGF Guarantee	68		
EAGGF Guidance	2	Development cooperation[1]	4
Social sector	6	Administration	6
Regional sector	5	Refunds to Member States	5
		Total[2]	100

[1] Inclusion of the EDF would treble this figure.
[2] Rounded total: 16 200 million ECU.

B — Revenue

During the early years the Community budget was financed by contributions from the Member States which were calculated on the basis of a fixed scale (or, more exactly, several scales which differed slightly depending on the Fund to be financed). The decision of 1970 established the principle of replacing these scales by the Community's own resources and, since completion of a transitional period, the budget is now financed entirely by the system of own resources.

These own resources are derived from three sources: customs duties, agricultural levies (and the sugar levy) and VAT. [1,2]

On the introduction of the Common Customs Tariff, it was considered logical, given that goods from third countries can enter the Community and be cleared in a Member State which is not the country of final destination, that the full amount of all duties should simply be allocated to the Community budget.

The same logic holds for the agricultural levies, which are in a sense analogous to protection at the frontiers. [3]

[1] In addition to these three sources, there are some other minor items of revenue, such as the tax on staff salaries, which produce about 1% of total budgetary revenue.

[2] There are special arrangements for the United Kingdom, under which its 'net contribution' is less than it would be under the general system.

[3] And also for the 'sugar levy' paid by producers to finance the costs of storage and the refunds following the sale of sugar on the world market.

The third form of revenue is provided by a proportion of VAT. The 1970 decision fixed the ceiling of 1% of VAT (i.e. 1% of value-added calculated according to a common definition which was finally formulated and adopted in 1979).

In 1980 these three sources accounted for 37%, 12% and 51% respectively of the total.

These proportions are changing, however. The share accounted for by customs duties has tended to decline as a result of the various measures adopted to dismantle tariff barriers against many third countries. The agricultural levies fluctuate quite widely over time. VAT will therefore gradually tend to become the basic source. In 1978 the rate was 0.64% of the assessment basis; it had reached 0.74% by 1979 and was 0.89% in the 1981 budget, so that the 1% ceiling has all but been reached.

The Community will therefore now have to make a choice between two fundamental options:

(i) either to retain the present ceiling, and consequently undertake a fundamental review of how these limited resources are to be shared out among the various items of expenditure;

(ii) or to raise the ceiling, an option requiring a unanimous decision by the Council. [1]

Whichever the alternative chosen, the budget is going to be seen as the key expression of the broad lines of Community policy, and this will add to the importance of the machinery for adoption of the budget.

C — Budgetary procedure

The Community's three decision-making institutions are all closely involved in the preparation and adoption of the budget. The fairly complex procedure is as follows:

— the Commission prepares a preliminary draft budget which it submits to the Council by 1 September;

— the Council, acting by a qualified majority, prepares a draft budget which it forwards to the Parliament by 5 October;

— the draft budget is referred back and forth between the Council and the Parliament.

A fundamental distinction is made between compulsory expenditure (expenditure necessarily resulting from the Treaties or from acts adopted in accordance with them) and non-compulsory expenditure. Currently, about 85% of the total is accounted for by compulsory expenditure, much of which is determined by past Council decisions; for instance, the amount of EAGGF expenditure follows from the level of farm prices fixed by the Council. The final decision on compulsory expenditure lies with the Council.

On the other hand, the Parliament has the power to determine the amount of non-compulsory expenditure, although within a specified limit; Article 203 of the Treaty fixes a maximum rate

[1] But such a decision would have to be ratified by each of the Member States according to its constitutional rules, which in most cases would require parliamentary approval.

of increase in such expenditure which is equal to the sum of half the growth rate in the Community GDP and half the growth rate in the Member States' budgets.

Final adoption of the budget is the prerogative of the President of the Parliament.

The texts laying down this procedure are in fact only apparently clear. The dividing line between compulsory and non-compulsory expenditure is open to dispute. Moreover, since 1977 the Parliament has had the authority to reject the whole of a draft budget and ask for a new draft to be submitted to it. Everything is therefore set up for a possible trial of strength between the Parliament and the Council, without any institutional provision for a solution to such a confrontation. Indeed, there was a delay of over six months before the 1980 budget was adopted and the 1981 budget was also the subject of dispute. Efforts are therefore currently being made to find a better basis for dialogue between the Council and the Parliament, which would benefit the Community as a whole.

D — Community lending instruments

In addition to its budget, the Community is able to call upon financial resources which it obtains by borrowing and uses to provide loans to finance operations of various types. The range and volume of these resources has steadily increased since the establishment of the Community. They are summarized below in chronological order of introduction of the instruments concerned.

The instruments of the ECSC comprise, in addition to subsidies financed by the compulsory levy on the coal and steel industries, borrowing facilities which are used to finance loans to support investment programmes in these industries (including housing programmes) or in other industries providing opportunities for redeployment of coal and steel workers.

The European Investment Bank established by the Treaty of Rome facilitates the financing of projects for developing less-developed regions, projects for modernizing undertakings or developing fresh activities, and projects of common interest to several Member States.

Recent years have seen the introduction of three other instruments in response to new problems:

(i) Community loans, introduced in 1975 to help some Member States over balance-of-payments difficulties in the aftermath of the oil price rises;

(ii) Euratom loans (1977), to provide finance toward the cost of building nuclear power stations;

(iii) the 'New Community Instrument' (1978), to promote convergence of national economic policies.

About half of the funds borrowed for these purposes is raised on Community markets, and the rest on markets in third countries.

The total amount is equivalent to approximately a quarter of the Community budget. Some countries tend to be allocated a greater share than others (for the period 1975 - 79, 33% of the total went to the United Kingdom and 31% to Italy) so that these loans play some redistributive role in the Community.

E — Position and role of the budget in the public finances of Europe

The Member States' national budgets currently perform the following functions: they use current expenditure to supply a variety of services to the national economy, and capital expenditure and certain subsidies to orientate the future development of the economy; by virtue of the volume of resources involved and the balancing mechanisms employed, they serve as instruments of short-term economic management; finally, through the provisions that they make regarding various transfers, they promote a certain redistribution of revenue.

The following three questions are central to any debate on the desirable size of the Community budget:

(i) How should the financing of public spending be shared between national budgets and the Community budget?

(ii) Should the Community budget play a role in short-term economic policy?

(iii) Should the Community budget be used as an instrument for redistribution among Member States?

At present, the shares of overall public spending borne by national budgets and the Community budget respectively vary enormously according to the function concerned, as may be seen from the table below (the orders of magnitude are still valid).

Breakdown between EEC and national budgets of public spending in the Community in 1976

	EEC budget %	Member States %
Administration of public services	negligible	100
Agricultural sector		
Guarantee	95	5
Guidance	8	92
Social sector	1	99[1]
Regional sector	10	90
Research, energy, industry, transport	4	96
Development cooperation	14	86
Total	2	98

[1] Including social security.

The areas in which there is a case for an increase in the share borne by the Community fall into two groups: those in which there is justification for common policies (or at least cooperation) and those which provide scope for redistribution among Member States.

The main fields in the first group are industry, energy, research and transport. If all the public funds allocated to these fields had come from the Community, the budget would have been increased by only about half.

In the social field, whereas some coordination of national practices may be justified, any massive channelling of funds, through a Community system (over and above appropriate financing of the Social Fund) seems undesirable.

The same may be said of development cooperation.

On the other hand, the Regional Fund is capable of becoming an important instrument for redistribution among Member States, on a scale depending more on political than on economic considerations. Suffice it to say that if all regional aid came from the Community, the budget would be increased by about 30%.

Altogether, the increases evisaged here, coupled with one or two very large projects (say between 1 000 and 2 000 million ECU), would have doubled the budget in 1976, assuming no reduction in the EAGGF. This gives a sort of working ceiling. The prospects for growth envisaged by the Commission are much more modest.

Even assuming the figures at the upper end of the bracket, the Community budget would still correspond to only 5% of public funds and less than 2% of GDP in the Community.

Would this be enough to make it a potential instrument of Community short-term economic policy? It would seem not. National governments, when seeking to influence short-term economic trends, resort to large variations (a few per cent of the total) in their total budgets, and these budgets are equivalent to between 20 and 25% of GDP.

The Community budget (supplemented by the loan instruments) therefore seems destined, at least for many years to come, to be confined to the fundamental role of steering the medium-term economic development of the Community by means of structural action. This makes overall policy-making on the Community's medium-term economic and social development all the more important.

Section 3. Medium-term economic planning

The Treaty makes no mention of any policy on growth which would be the responsibility of the public authorities. Its authors basically put their trust in market forces, in competition strengthened by the opening-up of frontiers and active vigilance on the part of the Community institutions, in movements of the factors of production and especially in the spontaneous gravitation of capital towards the most productive investments. The only specific references in the Treaty are to Community measures to facilitate occupational mobility of labour and national measures (monitored by the Community) to reduce regional imbalances.

In practice, however, all the Member States pursue policies on economic growth in one form or another and have procedures — whether formal as in France with the Commissariat au Plan and in Belgium with the Bureau de Programmation or informal as in several countries — for taking stock of prospects for the medium and long term and for scrutinizing policies in all areas to ensure that their aims are likely to be compatible over a number of years.

So could each Member State be left to define its own medium-term economic policy independently from what the others were doing, subject only to compliance with the rules of the Treaty? Three lines of argument lead to the conclusion that they could not:

(i) economic interpenetration influences the range of development options open to individual countries;

(ii) it is important for means as well as aims to be compatible, so that it is necessary to check that the means envisaged by one country do not interfere or clash with those used by another;

(iii) finally, it should be remembered that the construction of Europe is not a purely — or even primarily — economic process, but aims to be political as well; hence the importance of jointly defining the kind of society that the people of Europe want to build.

More generally, it is necessary to have a Community-level instrument for checking the consistency of various courses of action envisaged and their suitability to the various aims pursued.

In 1964 the Council, acting on a proposal from the Commission, accordingly set up an Economic Policy Committee responsible in particular for preparing a preliminary draft of a medium-term economic policy programme outlining in broad terms the economic policies which the Member States and the institutions of the Community intend to follow during the period under consideration, and designed to ensure the coordination of such policies. That programme covers a period of about five years. On the basis of the work of the Economic Policy Committee, the Commission draws up a draft programme which is finally adopted by the Council.

Five programmes have so far been adopted, the most recent of which covers the period 1981 - 85.

The role of this programme is ambiguous, as indeed is that of all experimentation with medium-term planning in the Member States. The exact function of such planning in decentralized market economies has yet to be defined. First of all, the more uncertain the future, the more necessary forward thinking becomes, despite the difficulties. But a programme is more than this and, faced with an uncertain future, it should lay down a thoroughgoing strategy for adaptation to a changing environment, so as to give the best opportunity of getting as close as possible to the general aims envisaged. The work being done currently, both at Community and national level, still concentrates largely on analysis of problems and their various possible solutions, without going beyond this stage.

The fifth programme points to two essential conditions for renewed growth and an improved employment situation:

(i) inflation must be curtailed: this is essential if investment is to recover and can be achieved only by means of a rigorous monetary policy; at the same time, public-sector deficits must be reduced and greater discipline must be introduced into the movement of incomes and prices;

(ii) economic structures must be adjusted by encouraging investment and innovation, adapting the supply of energy and improving the effectiveness of public expenditure.

These are problems which are vital to all the Member States and joint consideration of them by the 10 partners helps considerably in itself to draw points of view together and reduce the risk of incompatible decisions. Similarly, the longer-term analysis by various groups or experts that has been arranged by the Commission answers the same concern to exchange opinions.

It is nevertheless clear that the Community cannot confine itself indefinitely to analytical work. The pressure of the ceiling on budget revenue, the need to define an external strategy and draw corresponding conclusions as regards structural policy, the difficulties over energy supplies, the struggle against unemployment, and the arrangements for the next enlargement are all problems which call for coordinated responses. The ideal framework for defining such responses could be a real medium-term programme, one which would not lay down detailed stipulations, but would set out an overall strategy embracing the Member States' national programmes.

Conclusion — New strategies to meet new problems

The construction of Europe gives the impression of being well under way but far from complete. In the normal course of events, the dismantling of barriers should have been followed by constructive developments strengthening Europe's position in the world. The evidence of this booklet demonstrates that there has been real success in the execution of the first part of the programme, which has brought substantial benefits, but that there is a profound lack of resolution about moving on to the second stage, which requires real commitment to the task of creating a European economy in the full sense of the term.

Economically and politically the Community is thus off balance. The choice therefore has to be made: if we do not go forward, we must go back.

The simplest answer is that we must continue along the course that we have plotted. But is it the wisest? Plenty of doubts have been expressed. The world has changed so much that the plans which were best suited to the needs of 25 years ago are perhaps no longer right for today and tomorrow. In this connection, two questions in particular clearly have to be answered. First, is the idea of a community of several nations still valid? Secondly, do the original views on the best geographical scope for this community still hold good? In other words, is it right to persevere with the construction of Europe and, if so, along what lines?

A — In a different world, the construction of Europe is still necessary

The world has changed a great deal in the past 25 years. Despite the past (and continuing) vicissitudes of relations between the two superpowers, peaceful coexistence has survived, although with unrelenting efforts by each side to gain ground while containing the advances of the other. We therefore live in a world of permanent confrontation in which the ability to speak with a strong voice and make oneself heard depends on the possession of military strength (and the economic strength on which it must be built). At the same time, the balance of the world economy and international trading conditions are undergoing profound changes as new forces emerge. The rise of Japan, which has been the economic phenomenon of the past three decades, is going to be followed by that of the newly-industrializing countries, such as South Korea, Taiwan, Singapore and Hong Kong in Asia and Mexico or Brazil in Latin America. This will make for tougher competition in the more traditional industries and make it necessary to switch more quickly into high-technology areas. However, technological progress, which owes much to the stimulus of American and Japanese research, is developing along lines which favour large-scale production (long production runs or large production units).

Finally, supplies of energy products and raw materials, in which Europe's own resources fall dramatically short of requirements, are tending to be controlled by cartels or monopolies.

It is no doubt possible for a single country relying on skilful trading to steer a course that keeps within these various external constraints, but it is much more difficult to visualize several countries successfully embarking on their separate courses without to some extent damaging one another's interests.

The powerful arguments in favour of creating a large market — by which several European countries were sufficiently convinced to make the effort — have now been reinforced by arguments of equal strength (although based on international rather than internal considerations) demonstrating that it is in the interests of European countries to enter into partnership so that they can take joint action and pursue common policies. The concept of an economic community seems more relevant to current conditions than ever before, as witness its adoption — although with modest results so far — in other continents, such as Africa or Latin America.

It is therefore necessary to build an autonomous economic entity on the foundations of its own cultural values. There is no doubt that there are identifiably European cultural values; although we are struck by the diversity of our countries and peoples, when Europe is viewed from another continent it gives a strong impression of homogeneity and unity. Moreover, it will be extremely helpful to the very balance of the world, as it develops away from bipolarity towards multipolarity, for Europe to be gaining in strength, having cast aside all ambitions for world power, but willing to play its part in building a new international order and able to maintain dialogue with all nations, calling upon its Member States' long traditions of relations with countries all over the world.

There is therefore a compelling case for the European Community. But how should it develop?

B — A strongly structured Community is needed

Is it enough to settle for a common market, or is something more needed? There are those who are strongly tempted, whether for reasons concerned purely with national interests or because of the difficulties of creating a real Community, to opt for a common market only, which would mean a retrograde step in comparison with the present situation. This may appear to be the easy way out, but it would solve nothing.

First of all, the level of the common external tariff is now so low — and above all so uniform — that it affords absolutely no protection; the European common market has become an open market for all signatories of GATT. Secondly, more and more agreements are being signed between European and foreign companies. After a few years of this combination, the European economic area would be readily accessible to other countries without benefit of any real reciprocity and many of its production units would be dependent on others in third countries, again without any reciprocity.

In addition to this, by opening up their economies to such an extent, the various Member States would be increasing their exposure to the influence of trends abroad. It would therefore be necessary to develop concerted planning of national short-term economic policies with the United States of America and Japan, which would be the dominant partners by virtue of their economic weight, and this whole process would take place in a currency area dominated by the dollar.

These developments would be sufficiently gradual for the disadvantages to make themselves felt only slowly; by the time the need for corrective action had become clear, it would have become very difficult.

European protectionism has been suggested as a possible course of action. Since many of our problems are attributable to our policy of open trading, let us close our frontiers partially, and above all selectively, so that the main effect is felt by those who trade less openly than we do. For all its apparent good sense, this solution falls into the error of remaining on the defensive. Temporary action along such lines in a limited number of clearly defined cases can certainly be justified. But to make it the sole basis of policy would surely lead to failure; sooner or later, Maginot lines are always circumvented.

If Europe (and therefore each of its Member States) is to play a role in the world once again, the only positive course is to create a properly structured Community. This task has been started. How should it be continued?

C — *The priorities*

The refrain of a few years ago — completion, consolidation, enlargement — still remains valid today, especially when emphasis is placed on the indissociability of the three parts, of which the second is the main link.

Completion. — The main point here is that, having created the common market, it is necessary to remove the various barriers that remain. This does not mean aiming for perfection; the United States is often held up as the model of a large market, but it is a market which is less perfectly fluid and transparent than many people realize: there are still substantial disparities between the 50 States in such areas as taxation, technical, banking and other regulations, and social legislation. The aim, in the medium term at least, is therefore not the total elimination of disparities, but the disappearance or at least reduction of those which are most disruptive, and certainly the avoidance of measures creating new disparities. This is an unending task calling for much care, attention and discretion, a modest task, but one of fundamental importance.

Enlargement. — Given the profoundly political and cultural motives behind the construction of Europe, membership of the Community must be open to all other European countries, as soon as they are willing to join and are not prevented from doing so by considerations of international balance.

Greece formally became a member on 1 January 1981. Spain and Portugal have applied for membership and accession negotiations are proceeding. Although Austria, Sweden and Finland are unable to join at the present time (for foreign policy reasons partly outside the Community's and their own control), it is to be hoped that Norway's refusal will be only temporary.

Consolidation. — The purpose here is to strengthen the structures of the Community, the better to establish Europe's position in the world. There appears to be a need for action along four main lines:

(i) planned structural organization of the productive system;

(ii) better coordination of macroeconomic policies;

(iii) strengthening of solidarity;

(iv) improvement of the decision-making process.

These four lines of action are profoundly interdependent.

With the prospect of a sustained rapid rate of technological progress and an international environment in which the newly-industrializing countries will be making their mark, industrial structures in the Community are bound to undergo rapid change over the coming years. All our governments are trying to deal with the problems involved and implementing measures inspired by both economic and social considerations. However, there is every reason to fear that such measures, if taken separately, will be incompatible one with another, leading to a situation in which too many companies, or too many countries, would be aiming for the same specializations and seeking to penetrate the same markets, at the risk of creating excess capacity and disrupting markets, so that there would not even be any guarantee that 'the best man would win'. Community action is therefore urgently needed to organize intensive consultation and the requisite degree of coordination over industrial redeployment within the framework of a common standpoint on international economic relations. As mentioned in Chapter I, such action is equally necessary if full advantage is to be taken of the Community's size in areas where size is a decisive factor.

National short-term economic policies have become closely interdependent and better and better provision for coordination is needed. This is a prerequisite for successful operation of the European Monetary System, which should become the basis from which the Community can gradually develop its own monetary zone and its own currency.

Clearly, the concept of the Community is closely bound up with that of solidarity. However, few of the Community's actions hitherto have been motivated by solidarity, perhaps because it is interpreted too restrictively as leading only to various financial transfers which are perceived as an immediate gain (or loss). Solidarity should be interpreted much more dynamically, as a commitment on the part of the Community as a whole to help its less prosperous components (regions, branches of industry) to recover through the use of a whole range of measures (not only direct financial aid, but also technological aid, stimulation of capital movements, etc.) in pursuance of a multiannual recovery and development programme.

For action along these lines to be effective, there must be a common view on how the Community should develop and it must be possible for decisions to be taken rapidly.

The joint formulation and adoption of a real medium-term programme which would be seen as the basis of a strategy for the Community's development, taking in both the internal and international aspects, would represent a considerable step forward.

This programme would be adopted — and periodically adjusted — by the ultimate decision-making body, the Council of Ministers, which would adhere to very broad guidelines laid down by the European Council and concentrate on major policy decisions. It could provide the framework for *ad hoc* decisions on various matters, the main responsibility for which would rest with the Commission. This would make for a better allocation of tasks among the Community institutions and greater speed of decision-making, which is vital in a constantly changing world.

However, it is clear — and we always come back to this — that the making of Europe will succeed only if the people of Europe are determined to make it succeed. Europeans must therefore be convinced that the thing can be done and that it will be beneficial to all Member States. It is the fundamental role of the Commission to demonstrate untiringly, in good times and bad, that the construction of Europe, far from being a 'zero sum' game, is capable of generating a surplus over and above the product of purely national strategies in juxtaposition and to define the basis for sharing this surplus so that all benefit. The Commission must also provide concrete evidence to show that each of its proposals is directed towards the achievement of this surplus, so as to persuade members who are not always convinced at the outset of the benefits of Community measures. Bold decisions need to be taken; it is the role of our governments to be open-minded in their attitudes, to base their thinking on medium-term and long-term prospects, and to accept that every country cannot benefit from every transaction, as long as a sufficient number of measures are adopted simultaneously to ensure that there will be economic, political and cultural benefits for all. However, democratic governments can only act according to the wishes of the peoples who elect them — indeed, it is their duty to do so. All Europeans, and especially readers of this booklet, should therefore ask themselves three questions. Do they really want European culture to be preserved and developed? Do they really want the countries of Europe to be able to play a positive role in the creation of a better and fairer world? Do they truly believe that the only way to achieve complete fulfilment of both these aspirations is to succeed in the construction of Europe? If their answer to each of these questions is 'yes', they should do everything in their power to ensure that all the energies of this continent are devoted unstintingly to carrying on the task launched on a tide of enthusiasm 25 years ago.

Some key statistics (1982)

	Area (1 000 km²)	Population (million)	Population per km²	GDP at market prices (1 000 million ECU)	Exports	
					Total (1 000 million ECU)	Of which exp. to the EEC (%)
EUR 10	1 658	271.8	164	2 903	602	51.7
FR of Germany	249	61.6	247	673.8	180	48.1
France	544	54.2	100	552.9	94	48.7
Italy	301	56.6	188	352.6	75	45.9
Netherlands	41	14.3	349	139.6	68	72.2
Belgium	31	9.9	323	85.4	} 54	} 70.6
Luxembourg	3	0.4	141	3.4		
United Kingdom	244	56.3	231	480.8	103	41
Ireland	70	3.5	50	17.8	8	70.6
Denmark	43	5.1	119	57.7	16	48.6
Greece	132	9.8	74	39.0	4	46.3
Spain	505	38.1	75	185.1	21	52.9
Portugal	92	10.0	109	23.8	4	57.3
United States	9 369	232.1	25	3 082.8	217	22.6
Japan	378	118.5	313	1 073.7	142	12.3
USSR	22 402	271.0	12	:	89	21.1
World	135 830	4 586.0	33	:	1 863	:

	Labour force as % of total population	Labour force by sector (%)			Origin of GDP (%)		
		Agriculture	Industry	Services	Agriculture	Industry	Services and pub. admin.
EUR 10	43.6	7.7	36.2	56.1	4	39	57
FR of Germany	44.6	5.5	42.7	51.8	2	44	54
France	43.1	8.4	34.6	57	4	37	59
Italy	40.9	12.4	37	50.6	6	41	53
Netherlands	39.8	5	28.7	66.3	5	36	59
Belgium	42.4	3.0	32.3	64.7	2	34	64
Luxembourg	44.0	4.7	36.8	58.5	2	30	68
United Kingdom	47.0	2.7	34.7	62.6	2	38	60
Ireland	36.8	17.3	31.1	51.6	10	37	53
Denmark	52.4	8.5	26.3	65.2	5	26	69
Greece	39.7	30.7	29	40.3	18	30	52
Spain	34.6	18.3	33.9	47.8	7	36	57
Portugal	43.4	26.8	36.5	36.7	8	38	54
United States	47.5	3.6	28.4	68	3	33	64
Japan	48.8	9.7	34.9	55.4	3	42	55
USSR	47.4	20	39	41	:	:	:

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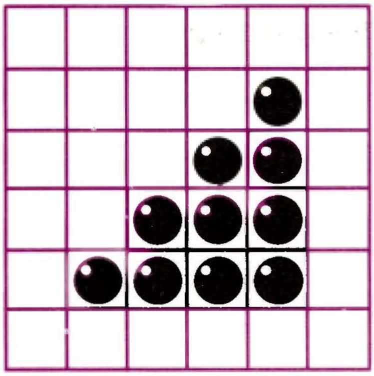

The countries of Western Europe have, in the vast economic entity that they are forming, the most solid assurance of lasting prosperity. For the rest of the world, an integrated European Community is a key factor in the establishment of a new international economic order.

However, economic arguments and the dynamics of economic forces are not enough in themselves to make countries embark upon the course of true integration; it was an awareness of economic needs coupled with a political will that inspired the Treaties of Rome, an original approach to the creation of an economic community which had no precedent in history.

This booklet gives a comprehensive description of the European Community which, over a quarter of a century, after the signing of the European Treaties, has become a reality, despite the difficulties confronting it in a troubled world.

It shows how the Community is approaching the task of achieving fuller integration, with the ultimate aim of economic and monetary union.

It gives a general account of the progress that has been made to date and the tasks that lie ahead.

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