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The economic and social cohesion of the Community

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Preface

Perhaps the greatest economic challenge facing the Community in the last years of the 20th century is how to increase economic and social cohesion. With the adhesion of Spain and Portugal, the Community includes most Western European countries and is the biggest exporter and importer in the world, with an internal market comparable to that of the U.S. and greater than Japan's.

The Community's potential for development through the completion of the internal market, increased coordination of economic policies, and further monetary and financial integration is very great. However, for this potential to be realized the Community must also overcome serious problems, the main one being the tendency for their growing to be a disparity between the more and the less developed Member States and regions. Therefore strengthening the economic and social cohesion is the principal Community objective for the years to come.

The present paper attempts to give a global view and to clarify the impact of various Community policies on economic and social cohesion. Further it suggests additional measures that would promote economic and social cohesion.

It is hoped that the present paper will be a positive contribution to the discussion of this topic and to the related questions and problems.

Francis ROY
Director General a.p.

Contents

1. Introduction

The present study examines the impact of the Community on growth and inequality among Member States, in order to make an appraisal of the Community's contribution to economic and social cohesion in the past. Past results will help to make some forecasts about the possible contributions of the Community in future and also about the necessary options the Community faces in the field of policy making.

As indicators for economic and social cohesion, the study takes GDP per head in the Member States. It postulates that an increase of GDP per head (i.e. a positive contribution to growth by the Community) is a positive element, in that it also increases economic and social cohesion. Also, a contribution of the Community to the lessening of inequalities among the Member States, measured by a comparison of GDP per head between the most and the less developed Member States, would be a positive contribution to economic and social cohesion. On the other hand, a widening of inequality (of the gap between the most and the least prosperous Member States) would reduce economic and social cohesion in the Community.

2. The impact of the Community on welfare and growth

The theory of economic integration seeks to answer the question "What are the expected effects of forming a customs union or a common market?". According to the theory, 5 types of integration processes can be distinguished: Free Trade Areas, Customs Unions, Common Markets, Economic Unions and Unification. The EC, as it now stands, is an Economic Union, characterized by elimination of customs in the interior, a common external tariff, liberalization (in part) of factor of production movements (labour and capital) and some harmonization of national economic policies (for example in the field of monetary policy, the EMS, and in the field of fiscal policy the VAT, plus regional, social and research policies).

Most empirical studies undertaken to measure the effects of the EC use the concepts of "welfare", "trade creation" and "trade diversion". Trade creation occurs when following the creation of a customs union, imports from a cheaper source replace more expensive imports. Trade diversion occurs if more expensive production or imports replace cheaper imports after the creation of the customs union. This can occur if imports from a member of the union become cheaper because they are no longer subject to a duty; while the imports from a third country become more expensive on the home market, because they will be subject to a common external tariff.

Thus, answering the question of the desirability of forming a customs union and a common market becomes an empirical matter. Customs union theory cannot give an ex-ante answer. There are, at the moment, more than 25 estimates regarding the global effect of the EC in terms of trade creation/diversion[1]. The main findings are: a) Trade creation exceeded trade diversion; b) No precise order of magnitude can be established since within the same year, depending on the methodology and the assumptions made, one result can be four times larger than the other; c) There is a tendency for the effects to be greater if a longer time horizon is considered. So, in spite of a step-by-step process of tariff dismantling and of possible bias due to inflation and methodologies used, integration has had positive effects in the case of the Community.

The assumptions[2] necessary for the estimations of welfare effects are very restrictive, being the assumptions of general equilibrium economics. General equilibrium economics is criticised for having very little resemblance to the real world economy, and its assumptions, even if taken as heuristic functions, are considered by some authors to be totally irrelevant. The most constraining of these assumptions is the static nature of the theory (the integration process is dynamic), the immobility of factors (in the EC the factors are mobile) and the automatic adjustment in the balance of payments[3].

As mentioned above, the ultimate yardstick by which to decide upon the interest of forming or joining an economic union would be the impact on real per capita income. But the impact mainly depends, not on the static effects that customs union theory takes account of, but on dynamic effects.

These are: (a) Induced investment; (b) Efficiency; (c) Specialisation which results in structural changes in the economy; (d) Terms of trade effects; (e) Balance of payments effects.

Some authors[4], estimating that integration effects are mainly derived from trade use the foreign trade multiplier for measurement of the integration effects, with export growth as the major component of autonomous demand. This framework, instead of the trade creation/diversion and welfare effects, uses total trade effects to estimate changes in output which are both simpler and more accurate. It takes into account the import side through changes in the income elasticity of demand from imports.

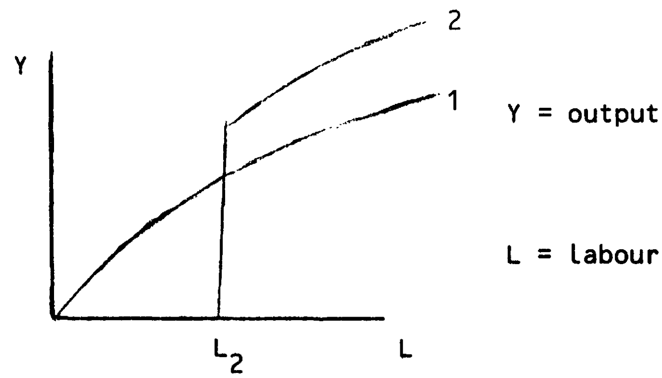
The estimates of one study[5] using this method are that in the period 1961-1972 the Community (and integration) contributed by more than 2% to the rate of growth of GDP. These are values much higher than those estimated by the welfare-customs union method. For the most favoured countries (Netherlands, Belgium and Luxembourg) integration during this period accounted for about 55% of the actual growth rates experienced by these economies. The effects of integration continue also during the second period examined in the study, 1974-1981.

Denmark, one of the new members, is the only EC country that has apparently lost from integration mainly because it did not have a significant amount of trade creation, which even showed a declining trend, as can be seen from Table 2. France, in contrast to the period 1961-1972, (see Table 1) was the country which fared best in both absolute and relative terms, with over half its actual growth rate accounted for by integration effects. Comparing the performance of the new members with that of the former members, the new benefited least in absolute terms relatively to all the older members, although in relation to the actual growth rate the UK apparently experienced a larger benefit than the Netherlands and Italy. This performance deserves particular mention, since large sectors of public opinion in the UK believe that integration has worsened the rate of growth through adverse balance of payments effects. In spite of adverse effects of the CAP, the results show that integration accounts for about 30% of growth during this period.

It can be argued that new members adhering to the Community need a certain period of time for their economies to adapt to the new situation, before they reap the full benefits of the integration process. This could explain why some of the old Member States, for example France, experience a negative effect in the first period and a positive one in the second one, and why in the period 1974-1981 old Member States seem to have benefited on the whole more than the new ones.

The study concludes that: "...for the past quarter of a century, the EEC integration scheme has played a major role in the economic growth achieved by Europe. If the estimates are accepted we can say that in 1972 the GDP of the EEC was 2.2% higher than it would have been without integration and after enlargement, the EEC ended up in 1981 with a GDP that was 5.9% higher than in the non-integration situation"[6].

The methodology of the above mentioned study is a big improvement on customs union studies, mentioned in the beginning of this part. Still, it does not cover completely all dynamic effects like efficiency gains. If, for example, market integration leads, through increased competition, to improved firm efficiency (and to more firms of near optimum firm size in all Member States) trade flows could remain more or less unchanged, but overall productivity would increase substantially, and thus also the growth rate. In this case there is a shift in the production function that is not captured by trade flows, because it does not affect intra-EEC competitiveness (since many EC firms in different Member States experienced it). So the above mentioned results of the influence of the EC on growth rates may still be an underestimate. But it can safely be concluded that the EC has contributed positively to growth and therefore to economic and social cohesion.



1 : Old production function, before efficiency gains due to integration.

2 : At point L_2 firms reach optimum size and thus there are efficiency gains (due for example to economies of scale). There is a shift to the higher production function.

The shift in the production function could also be brought about by the implementation of common, pre-competitive research. Spillover effects of such research are shared by all firms and so do not change their competitive position inside the Community (but do increase their extra-Community competitiveness) and so are not reflected in changed intra-EC trade flows.

3. The impact of the Community on inequality

While econometric estimates are almost unanimous that the EC has contributed positively to welfare and growth, the existing literature is far from conclusive on the question of inequality, some studies suggesting an increase in inequality, others a reduction and some being inconclusive. The reasons for such disparate predictions derive both from the inherent difficulty of the questions and from deficiencies and/or inadequacies of the methodologies used. In a non-exhaustive enumeration of these one can mention the absence of a precise definition of what is meant by divergence; the difficult choice of an appropriate inequality measure; the use of only a few point estimates to deduce trends; the non-compatibility of data bases and the absence of a control group of countries with which comparisons can be made.

In the present study the "income per head gap" is used as an indicator to measure inequality. "Income per head gap" A_1 is defined as the difference in percentage of the incomes per head of two countries:

Table A

Year	G_1	A_1	G_2	A_2	G_3	A_3	G_4	A_4	G_5	A_5
1960	44.5	53.5	56.7	43.3	48.0	52.0	32.4	67.6	21.2	78.8
1973	50.0	50.0	49.3	50.7	37.7	62.3	31.6	68.4	22.4	77.6
1981	59.9	40.1	56.0	44.0	47.5	52.5	34.0	66.0	21.5	78.5
1987*	65.2	34.8	57.0	43.0	46.9	53.1	23.0	77.0	17.3	82.7

G_1 = Italy/Luxembourg
G_2 = Italy/Denmark
G_3 = Ireland/Denmark
G_4 = Greece/Denmark
G_5 = Portugal/Denmark

G_1 : GNP per head of an Italian as a percentage of GNP per head of a Luxemburger etc.
The gap is then the difference of GDP's per head, i.e. $A_1 = 100 - G_1$ etc
1987 numbers are estimates
Source: Data of table 3.

According to the first ratio, A_1, the GDP per head gap of Italy and Luxembourg (at the time the poorest and richest Member States of the Community) was 53.5%, or an Italian's income was 44.5% of a Luxemburger's income.

The gap kept diminishing to reach 34.8% in 1987, when an Italian's income reached 65.2% of a Luxemburger's.

Observing G_2, Italy with Denmark (which became a Member of the EC in 1973 and was at the same year the richest EC Member State) the gap increased from 1960 to 1973 (A_2 in 1960: 43.3%, A_2 in 1973: 50.7%) and then diminished till 1987, when Italy's GDP per head reached 57% of Denmark's (as against 56.7% in 1960). Still, taking the whole period 1960-1987, the gap remained more or less constant, being in 1987 smaller by just 0.3%

Observing G_3 (Ireland and Denmark) which were respectively the poorest and the richest Member State at the time of their adhesion to the EC in 1973, the gap increased during the non-adhesion period (1960-1973) from 52% to 62.3% (i.e. Ireland's income was 48% of Denmark's in 1960 and only 37.7% in 1973). Since then the ratio fluctuated but has not yet reached the 1960 level. In 1987 Ireland's GDP per head is 46.9% of Denmark's, still below the 48% of 1960, but above the 37.7% of 1973.

Observing G_4 (Greece-Denmark), which were the poorest and richest Member at the time of Greece's adhesion in 1981) the gap decreased from 67.6% in 1960 to 66% in 1981, and then increased again dramatically to 77% by 1987, i.e. Greece's GDP per head which represented 32.4% of Denmark's in 1960 was 34% of it in 1981 but only 23% by 1987.

Observing G_5 (Portugal/Denmark) as a control variable for a country which was not a Member State till 1986 with one which was, the gap remained fairly stable till 1981 (from 78.8 in 1960 to 78.5 in 1981) but then increased to 82.7 by 1987. This development is analogous to that of G_4, although Portugal was not a Member of the EC till 1986, while Greece was from 1981.

There is no clear cut result arising out of Table A. In some cases, differences and inequality have diminished (Italy) and in others they have have remained about the same (Ireland) while in others they have increased (Greece). One criticism of the use of GDP per head at current prices, is that the strong influence of exchange rate movements greatly affects the results. Thus, these results may be biased. Actually, the exchange rate of the Lira during most of the period, as well as the exchange rate of the Irish pound, the Greek Drachma and the Portuguese Escudo were being devalued against the Luxembourg/Belgium Franc and the Danish Kroner.

Table B gives the GDP per heads ratios using purchasing power parities (PPP).

Table B

Year	P_1	B_1	P_2	B_2	P_3	B_3	P_4	B_4	P_5	B_5	P_6	B_6
1960	52.3	47.7	--	--	--	--	--	--	--	--	24.5	75.5
1970	--	--	74.7	25.3	53.0	47.0	42.4	57.6	35.3	64.7	--	--
1973	62.0	38.0	74.4	25.6	53.4	46.6	47.5	52.5	41.3	58.7	39.4	60.6
1981	76.4	23.6	81.2	18.8	62.1	37.9	50.9	49.1	43.5	56.5	47.9	51.1
1984	69.8	30.2	74.9	25.1	58.2	41.8	46.9	53.1	--	--	43.8	64.2

P_1 = Italy/Luxembourg
P_2 = Italy/Denmark
P_3 = Ireland/Denmark
P_4 = Greece/Denmark
P_5 = Portugal/Denmark
P_6 = Greece/Luxembourg

The gap is defined as in table A.
PPP statistics not yet available after 1984.
Source: Data of Table 4.

Observing B_1 (Italy having the lowest and Luxembourg the highest GDP per head according to PPP), the gap shows a steady diminishing from 1960 to 1981 and then increases again by 1984. The same is true also for B_2.

Observing B_3, (Ireland having the lowest GDP per head after enlargement in 1973) the gap diminishes up to 1981 and starts to widen again after 1981. The same applies also to B_4 and B_6 (Greece/Luxembourg, Luxembourg remaining throughout the period the Member State with the highest GDP per head according to PPP. Denmark has the highest GDP per head after 1973, using current prices and exchange rates. Greece was the country with the lowest GDP per head after the second enlargment in 1981 and before the third of 1986).

What is striking when using PPP is that there is a steady converging of GDP's per head and a parallel reduction of inequality up to 1981 both for Member States and for non Member States (Greece and Portugal). On the other hand, after 1981 there is a consistent widening of the gap and increasing inequality shown by all ratios. Unfortunately no PPP is available for 1984 for Portugal, so that there is no control ratio. Still, the result is clear: Up to 1981 integration was related to convergence and diminishing inequality, while in the period 1981-83 divergence and inequality increased.

The Community failed to bring about more equality and convergence during the period 1981-1984. This of course does not yet mean that the widening of the gap was due to the Community, because non-participating countries may have also shown similar developments. But the fact is that the EC policies were not sufficient to counterbalance these diverging economic trends and to bring about increased convergence after 1981.

We conclude that economic policies followed by the Member States were more important for the development of convergence/divergence than the implementation of Community policies. The influence of most of these policies, (regional and social policy mainly) were positive but insignificant in their impact, while the influence of CAP was negative and significant. This may have been a source of inequality that can be directly attributed to the EC.

The basic aims of the Community, in order to increase economic and social cohesion, are the modernisation and adaptation of the economic structure of the less developed Member States. This modernisation includes the support and reinforcement of existing structures and their adaptation to increased competition, as well as the creation of new productive capacity in technologically more advanced fields. This effort cannot be based solely on national resources and policies, although both play a very important role. On the other hand, capital insufficiency always characterised the less developed Community economies, while national policies are constrained more and more by Community policies and international interdependence. Thus, enhancing the economic and social cohesion of the Community presupposes an important Community contribution to its less developed Members and an adaptation of Community policies towards the aims of increasing growth and reducing inequality.

In the following sections the impact of the Community policies are examined.

4. The Single Act, Convergence and Cohesion

The Single Act sets new objectives for the Community, including the completion of the internal market and the achievement of economic and social cohesion, which will reduce inequality. Completion of the internal market is vital for growth, while greater cohesion is a political and economic necessity following enlargements.

Still, when trying to realise the two objectives of growth and the reduction of inequality, some basic questions have to be asked. The realisation of the internal market, allowing increased mobility of factors of production (labour and capital) resources and goods, will promote growth. What is not so clear is if it will reduce inequality, or if it will increase it. The reduction and elimination of internal barriers could result in an outflow of factors of production and resources from the poorer to the richer regions within the Community, Or, on the contrary, the reduction and elimination of internal barriers could bring resources to less developed regions. Unfortunately, both economic theory and experience do not provide unequivocal answers to the three basic questions:

(1) Is there a trade-off between growth and inequality?
(2) Do we have to pay for higher growth with increased inequality?
(3) Do we reduce growth, when trying to reduce inequality?

Lacking a clear-cut economic answer to the above questions, the Community and before it and parallel to it, the Member States come up with a second best solution, based on social and political criteria. Inequality must be reduced through redistribution of resources, even if it has some negative effects on growth, because for social and political reasons an increase of inequality in the Community is unacceptable. Still, redistribution through the structural funds must not become the main objective, the main objective remaining measures that enhance growth, like better economic policies and their coordination, common research etc.

The Single Act instructs the Commission to submit to the Council a "comprehensive proposal... the purpose of which will be to make such amendments to the structure and operational rules of the existing structural Funds... as are necessary to clarify and rationalize their tasks in order to contribute to the achievement of the objectives, to increase their efficiency and to coordinate their activities between themselves and the operations of the existing financial instruments" (130 D).

Five priority objectives have been identified for the Structural Funds:

(1) Helping backward areas to catch-up
(2) Restructuring regions in decline
(3) Combating long-term unemployment
(4) Integrating young people into the working environment
(5) Developing rural areas, notably but not exclusively through the adjustment of agricultural structures.

These objectives should be achieved, according to the Commission[7], through two key principles:

(1) Preference will be given to multiannual programmes designed to complement action by the Member States and the regions themselves.
(2) Management will be decentralised as far as possible. Brussels must not become yet another centralising force but rather a base for generating and disseminating initiatives.

This is the background to the Commission's proposal to double the volume of the Structural Funds in real terms between now and 1993. It must be noted that actually the resources of the Structural Funds correspond to 0.2% of the Community's GDP.

The following problems exist in relation to the working of the structural funds and should be taken into account during the implementation of the "new" structural funds:

(1) The consistency and complementarity of national action and Community support

(2) The visible utility of Community support

(3) The adequacy of financial resources to secure a marked reduction in macro-economic terms of regional imbalances in the Community.

Action taken by the Community should be concentrated in those fields where it offers extra advantages in relation to national measures. The three cases specified in the so-called Varfis memorandum are those in which the integration of certain Member States is being hampered by a lack of national financial resources or by the weakness of the technical and administrative infrastructure; where the dissemination of successful examples can offer a synergy between national measures and where it provides a clear political signal of the Community's support for weaker regions.

The Commission has also stated in its recent memorandum on the reform of the structural funds that "through its structural funds and its financial instruments, the Community must help to generate an above-average rate of productivity growth in its less-favoured regions and must create there, through the financial assistance it provides, the conditions necessary for the mobilisation and for a spontaneous flow of capital." This increase in productivity growth is necessary to ensure a firm basis for economic expansion and to avoid excessive inflationary pressures.

It would appear then that the Commission sees the process of convergence as arising from a more rapid rate of investment in less-favoured regions. In promoting economic development in the regions, the role of public authorities in general, and of the Community in particular, is to facilitate private investment flows, to promote vocational training and to encourage the "exploitation of indigenous potential."

The major difficulty with the approach to convergence adopted by the Commission lies firstly in the uncertainty attached to the policy of promoting regional development by spending more public money on current schemes, in particular programmes to improve infrastructure and attract mobile investment. Existing studies of the effectiveness of regional policy measures produce different conclusions. Although regional disparities within Member States with a long tradition of regional policy have frequently not been narrowed, they might well have got worse in the absence of the national policies concerned. The precise impact of different types of regional incentive has not however been satisfactorily resolved. The Community has emphasised infrastructure spending under the ERDF and vocational training under the Social Fund: although in both cases these activities probably contribute to the growth of less-favoured regions and to convergence, it is not evident that the Community's money is best spent on building bridges and training technicians (assuming that the Community is in fact contributing to a net increase in these activities and that the fears in regard to absence of "additionality" are unjustified). Other types of policy with a regional impact may be more valuable in future, particularly if the total resources of the structural funds are increased.

A rise in economic activity in the less-favoured regions is correctly seen in the Commission proposals as dependent on a rise in investment. Most of this investment must come from private sources and a rise in private investment is more closely linked to government macroeconomic policies and to trends in the world economy than to improvements in public infrastructure and the supply of technicians. It is also strongly associated with the entrepreneurial attitudes and management capabilities of the people in the regions concerned.

Thus, while a major increase in the Community's structural funds is certainly desirable and probably essential for political reasons, the use that is made of these funds needs to be more closely linked to the real prospects of achieving a more rapid rate of private investment in the Community's less-favoured regions. While further improvements in infrastructure are necessary, examination needs to be given to the possibility of:

a) direct transfers to the government concerned to compensate for inadequate national fiscal capacity, but linked to improvements in administration and education in less-favoured regions;

b) stronger support for small and medium sized enterprises in both industrial and rural less-favoured regions, in particular for management training and for commercial research projects;

c) transfers to the natinal budgets of weaker Member States to provide enhanced social security arrangements or possibly to compensate for reduced contributions by employers and employees in the least-favoured regions.

It may well be argued that financial transfers to the governments of the weaker Member States should not be carried out by means of the structural funds. If this were accepted, however, consideration would have to be given to an increase in the ERDF and Social Fund and to the creation of other budget lines. In any case, it is evident that the total resources available from the Community budget for these purposes may not in themselves be sufficient to bring about convergence. As stated above, macroeconomic policies are likely to be more important. The granting of more resources from the Community budget to the development of less-favoured regions could be made contingent on the adoption by the governments of the Member States concerned of macroeconomic policies that will favour both an increase in investment and in cross-border financial flows which will strengthen the cohesion aand integration of the Community.

5. The Common Agricultural Policy

Econometric estimates arrived at both with the trade creation/diversion and other methodologies[8] support the widespread claim that the CAP was responsible as a source of economic inefficiency. The CAP has been responsible for an increase in inequality between Member States, in spite of favouring one of the poorest, Ireland. According to one estimate[9] the cumulative loss was around 1.7% of the Community's GDP by 1981.

Higher EC than world market prices meant surpluses and inefficiency in the Community while increased support for northern as against mediterranean products meant a net transfer of resources from the mediterranean countries (but also the UK) to the richer northern countries, increasing thus inequality. It must be said, however, that agricultural surpluses are not a phenomenon unique to the EC, but a problem faced by the agricultural sectors of all industrialised countries. All these countries support their agricultural sector on a massive scale. For this reason, GATT negotiations should lead to a reduction of subventions, but such a reduction would make no sense if it were not followed by the totality of industrialised countries.

If the EC cannot manage to give market prices a greater role in the interplay of supply and demand, the CAP will sink even deeper into a morass of administrative measures and rules for the quantitative regulation of production. This will provoke resistance from consumers and the development of substitute products, and will in addition cut off agriculture from the potential for developing industrial and food outlets through exports.

The Community must continue to try to bring intervention back to its original role of short-term market adjustment. Intervention must no longer be seen as an artificial supplement to the market, automatic and permanent, ironing out all market effects and preventing any action to bring supply on line with demand.

The Commission has indicated the approach it intends to adopt in seeking better balance on agricultural markets. This involves a restrictive pricing policy, more flexibility on guarantees and intervention mechanisms and a higher degree of producer co-responsibility, including recourse to quota systems.

It also intends to continue adjusting intervention mechanisms for the products where the major problems arise, especially by limiting buying-in to certain periods of the year, and by reinforcing measures to guide production towards those qualities which the market requires. The general aim is that farmers should gradually be induced to take greater responsibility for their choices of types of product and for finding unsubsidised outlets.[10]

Together, the reforms introduced since 1984 and the 1987 price package represent an annual budgetary saving of some 6,000 million ECU in constant prices.

The changes required in the CAP will be brought to bear on an agricultural situation which, in a Community of 12, is extremely diverse. There are great differences in natural and structural conditions of production and in the impact of agriculture on socio-economic balances and on the environment. The measures taken will bite more in the case of those farms which are economically and structurally weaker The action the Community is to take must allow for these facts and at the same time it must also avoid any tendency to sideslip into national or Community measures that may lead to unfair distortion of competition within a single market. That is why the Commission's proposals include differentiated measures to take account of the special situations of some farmers or some regions. But such differentiation cannot go beyond the limits imposed by a policy of improving the allocation of resources in the light of the comparative advantages enjoyed by each country and region. In order to achieve greater balance between the imperatives of the market and the need to reinforce economic and social cohesion, the Single Act provides for a revision of the Community's structural funds. This concerns the agricultural sector to a great extent, especially when one considers that for a great number of underdeveloped regions agriculture is the main economic activity.

In order to absorb the negative effects of CAP reform, the Commission proposed direct income aids, as well as prepension systems. These instruments are not an attempt to move away from an economic approach to agricultural policy, but represent the development of measures that would permit the transition to an agricultural sector with less employment. Still, some further problems must be solved. In the part Guarantee, the CAP is based on common criteria. On the other hand, the criteria used in the part Orientation of the CAP, are national. Thus, under the present system, the inequality between the Community's regions is not diminished, since regions that are considered to be less developed in a 'rich' Member State would be characterised as dynamic if they are part of a 'poor' Member State. This is why it is necessary to introduce common criteria in order to establish in future which regions of the Community will be considered as less developed for the purposes of the Orientation part of the FEOGA.

Intervention of the FEOGA-Orientation should have the following aims -

(1) The reinforcing of farmer's income that will be hit the hardest by the restructuring of the CAP, in particular in the less-developed regions of the Community,
(2) The possibility of developing in agricultural areas of activities complementary to agriculture, as tourism and some forms of handcrafts, in order to develop the endogenous potential of regions affected by the PAC's revision.
(3) The guarantee and conservation of social and economic characteristics of mountainous and less-developped regions of the Community, also as a part of environment policy,
(4) The development of new methods of agricultural production through the implementation of applied agricultural research programmes.

For the success of the above aims, a substantial increase of the Orientation part's resources is necessary. An increase to 25% (out of 5% today) of the Community's budget would be appropriate. This increase of the Orientation part would have to be matched by a more than equivalent reduction of the Guarantee's part expenses, so that CAP expenses reach in future a lower percentage of the Community's budget. This would free resources for other much needed Community policies.

The resources of the Orientation part of FEOGA should be used:

(1) For the amelioration of infrastructure of predominantly agricultural areas,
(2) To finance research in agriculture,
(3) To set up information services as to agricultural markets and prospects that would be accessible to farmers (so as to enable them to reorient their production according to Community total demand and the world situation),
(4) To train farmers so that they can use better farming methods and restructure, when necessary, their production,
(5) To support the introduction of modern management methods in agricultural enterprises.

6. Regional Policy

As seen above (Tables A and B) the Community did not reduce inequality among its Member States and the consequent enlargements with less-developped countries, like Ireland (1973), Greece (1981) and Portugal and Spain (1986) have increased regional inequality. The objective of aiding regions which have fallen significantly behind in terms of structure to catch up is the real crux when it comes to economic and social cohesion, as the Community is nowadays more heterogeneous and therefore more vulnerable than before. Two figures are sufficient to indicate the extent of this change: before Spain and Portugal joined, one European in eight had an annual income 30% below the Community average, while the figure in 1986 was one in five, although the average of 1986 (average of 12 countries) is lower than it would have been if the old average, without Spain and Portugal, had been taken. The magnitude of the problem in financial terms, of reducing inequality, can be illustrated by the following rough example. The average GDP/head of the Community in 1987 is estimated at 11.148 ECUS, that of Greece being 3.920 ECUS. Taking into account Greece's population of 10M, the gap that has to be bridged is about 72 billion ECUS! (The gap being calculated as: difference of EC-average GDP/head and Greece's GDP/head multiplied by Greece's population). Compared to this gap, the ERDF received 3.098 Mio ECUS in 1986 (about 8,5% of the Community's budget). Of course, the above is only a very rough estimate that should serve to indicate the impossibility of bringing about economic convergence only through financial transfers. Financial transfers, if used well, could contribute to growth rates and so help to bridge the gap, but other factors have an even higher incidence on growth rates. Such factors are general economic policy measures and their influence on the framework in which the economy operates, as well as their influence on the "economic climate" (for example the formation of expectations), the situation in the labour and capital markets (the legal framework for the regulation of the capital and the labour market, the bargaining process, the labour market etc), social attitudes, political stability or instability, natural resources, technology level and transfers etc. It must also be underlined, that ERDF interventions (and also national regional development aid) do have multiplier and linkage effects, so that an initial investment realises, over its entire time horizon, a multiple value in income and growth generated of the amount originally invested.

Some problems are related to regional policy. First there is considerable disagreement among economists as to whether regional incentives are or can be effective in bringing about a narrowing of the gap between rich and poor regions. The reasons for divergences in economic performance between countries and between regions are often very deep-seated and not necessarily amenable to treatment by a larger regional policy budget. Although a poor infrastructure, lack of natural resources or a peripheral location can adversely affect a region's economy, these are not necessarily the most important factors in determining its performance. Cultural traditions, education and training can be at least as vital and yet are frequently less susceptible to treatment by government policy-makers.

These considerations do not free the Community from its duty to try to promote economic development in its less favoured regions. Unfortunately, Regional Policy at Community level, as it is at the moment faces a serious problem concerning the creation of new economic activities in the less favoured regions. These regions are to be found in countries where public finance must face severe restrictions in future years. In these countries, public finance is insufficient to give either real incentives to private investment or realise the large-scale public investment which is necessary to the modernisation of the economies. So it would seem desirable that the ERDF undertakes 100% of all expenditure for regional development in the least favoured areas of the Community. At present, a major increase in the EC funds available for regional spending in the poorer Member States would put great pressure on the rule which requires the Member State itself to put up at least half of the public finance for a particular project. This rule has already been relaxed for Portugal which only has to find 30% in view of the extremely perilous state of its public finances. This lack of national resources to fund infrastructure and other regional projects could of course be relieved by a 'budget equalisation scheme' such as that also referred to in the MacDougall[11] conclusions, but direct Community funding of the whole cost of some infrastructure spending and all regional incentives for industry and services could be simpler for this and some other Member States.[12]

So, although regional aid should be regarded as positive in reducing inequality, its importance is secondary compared to growth enhancing economic policy. Further, the amounts needed to make a real impact in the reduction of inequality in the EC would require not a doubling of the Structural Funds (as envisaged by the Commission) but a multiple of the amounts actually available, although the doubling is a step in the right direction.

In addition to the increase of financial resources for the funds, which for the time being is not yet assured, the Commission proposes some reforms to ameliorate the impact of the Structural Funds and the ERDF in particular.

1. The Community's budget funds must be concentrated in the least favoured regions, i.e. all of Portugal, Ireland and Greece, some parts of Spain, the South of Italy, Northern Ireland, and the French overseas departments.

2. It is programmes which will constitute the central plank: the aim is to make sure that the Community's support for the Member States' efforts and initiatives is located at the right level. As opposed to action through projects, programmes will combine the following advantages:
   (i) they will associate effectively the specific intervention operations conducted by the various subsidy and loan facilities, each having its own responsibility and experience as regards regional development, employment policy and agricultural techniques;
   (ii) they will lead to decentralisation of Community action by giving maximum scope for local or regional initiatives, which are the most effective for investment and employment. Programmes will involve contracts between the Community, the Member States and the regions. They will involve joint preparation, monitoring and assesment, and they will thus lead to a fully-fledged partnership.

The European Parliament broadly supported the Commission suggestions on this subject as presented in its proposal for a Regulation the tasks of the structural Funds and their effectiveness and on coordination of their activities between themselves and with the operation of the European Investment Bank and the other financial instruments. Subject to a large number of minor amendments it approved this document in its resolution of 19.11.1987 in the Gomes Report[13].

Further to the Commission's proposals, it is necessary to have clear priorities for the interventions of the ERDF which could be made according to the following criteria:

(1) The quota system could be continued in future for the classic interventions of the ERDF, as for example the creation of new infrastructures, taking into account a parallel redistribution of the quota system according to the criterion of regional decentralisation.

(2) The financing of new types of intervention according to the regional needs and the possibilities (or not) of the national economy to support it. Such interventions could be financed by the special lines of the Community's budget.

7. Social Policy

According to the Commission's proposals, one side of the ESF's activities will follow regional eligibility rules and the second will be of horizontal nature, combatting long-term unemployment and integration into employment of young people. Community action will take place in the framework of programmes.

A number of problems still remain, however. The structure and the rules of the ESF are adapted to the labour markets of the more industrialised Member States and do not take sufficient account of the particularities of the less-developped regions, so that the structural character of this Fund is diluted. It is characteristic that the same criteria apply to all Community's regions, independently from these being developped or underdevelopped. The EST should be reformed in order to take into account the particularities of underdevelopped regions (like under-employment and low mobility of labour). Its field of intervention should be enlarged, and be specified taking into account the needs of the less-developped regions. The following proposals go into this direction:

(1) Adaptation of a special regulation for areas of absolute priority,
(2) Increase of the percentages (up to 75% for example) for interventions of the ESF in these areas,
(3) Greater regional concentration of the ESF interventions, with an increase of the quota for less-developped regions,
(4) Setting up of a system of centres for technical and professional education,
(5) Adaptation of pilot-programmes by the Community, on which priority will be given to the professional and social re-absorption of workers that move into other regions,
(6) The possibility of introducing a national quota system for the distribution of the ESF's resources could be examined. In this system, the less-developped countries would benefit from the increased quotas.

8. The EMS

As stressed above, appropriate economic policies are more important in order to increase economic and social cohesion than just the transfer of financial resources. In this respect the EMS has had some favourable results which will be continued in future. The EMS is vital to the implementation of a cooperative strategy because the relative stability of exchange rates provide participants with a guarantee that the efforts they undertake in pursuit of modernisation and competitiveness will not be undermined by aggressive exchange rate policies and because effective use of EC instruments for medium-term balance of payments support facilitates implementation of the most difficult cyclical adjustments. Monetary stability is capital for the formation of stable expectations whose importance for the good functioning of the economy has been widely accepted.

The EMS has resulted in a greater coordination of economic and monetary policies for the Member States participating in the exchange rate mechanism. Since the exchange rate becomes a monetary target per se, coordination of monetary and economic policy becomes a necessity. On the other hand, in some instances, the Member States have chosen the easier way of devaluation, instead of a change in economic policy, but this phase seems to be at an end. Further, the EMS offers the advantage of sharing the burden of adjustment with the partners in cases of realignment of exchange rates, since the new exchange rates come about by common agreement.

It would be an advantage for the Member States that do not participate in the exchange rate mechanism of the EMS (UK, Greece, Spain, Portugal) to participate in the near future. On the other hand, participation would help some of these countries in reducing their above-average rates of inflation.[14] The EMS has brought about more anti-inflationary economic policies than would have been the case in its absence for some Member States and this has contributed positively to growth; gains that cannot be measured, because there is no methodology that permits a separation of growth rates directly attributed to better economic policy due to the EMS.[15]

Monetary unification remains one of the Community's aims. On theoretic considerations it is expected that this will contribute positively to growth but may under some aspects increase inequality by having negative effects on the less developed regions. (For example increased capital outflow from these regions under unification, where transaction costs will be lower or non-existent, due to better investment opportunities in the more developed regions)[16]. Still, complete monetary unification for the Community lies in the distant future.

The Single Act does not go very far concerning monetary and economic union. It is stated (Article 20) that Member States cooperate in the field of economic and monetary policy, in order to guarantee the Community's further development. It is not stated, on the other hand, what form this cooperation should take and what instruments should be used, with the exception of mentioning the experience gained under the EMS. Indirectly the EMS is recognised as a prerequisite for rapid economic growth in the Community and consequently a major force for cohesion.

It will be an advantage for their economies for the Member States whose currencies do not participate in the exchange rate arrangement of the EMS, to do so in the near future. This could bring about a more disciplined monetary policy, from which their economies would benefit.

The EMS can be strengthened in the following ways:

(1) Through more effective coordination of interest rate policies, which has been conspicuously absent recently,
(2) The divergence indicator could become a positive trigger for coordinated and balanced intervention by the central banks,
(3) Through increased use of the ECU and a wider regulating role for the European Monetary Cooperation Fund,
(4) To make the ECU a reserve currency and a means of payment,
(5) By the complete liberalisation of capital movements,
(6) By completing the EMS through the introduction of a common policy towards third currencies, in particular the dollar and the yen.

The last point is very important, because actually tensions in the international monetary scene, e.g. the devaluations of the dollar, create tensions inside the EMS that are often leading to realignments of central rates, as recently. This occurs because some EMS currencies like the DM, are much closer substitutes to the dollar than others, so that capital outflow from the dollar goes mainly to the DM, putting it under pressure to appreciate also towards the other EMS currencies[17].

9. The internal market

The Community's first concern during the period up to 1992 must be to keep up the momentum created at the end of 1986 so that work on completion of the internal market can proceed in accordance with the programme set out in the Commission's White Paper. Attainment of this objective is a prerequisite for an efficient, modern Europe that will provide industry and commerce with a structural framework in which they can be fully competitive. Each institution has an important role to play in this process. The Council has been given the means of speeding up decision-making while the new cooperation procedure gives Parliament a far wider role than in the past in this area.

As with monetary unification, the completion of the internal market could also have a negative impact on less developed regions of the Community, permitting as it does increased competition and bringing about possibly an outflow of resources. Competition, leading to more efficient production, creates in the end overall growth and is positive from the Community's point of view but may have a negative transitory effect on inequality. This is why some counter-availing measures, possibly of a temporary nature, may have to be introduced. Such measures could be introduced by giving aid to the less-developed Member States for them to ameliorate their infrastructure in the fields of norms and metrology, packaging and quality control. The Community could further introduce a strategy also in the sector of certification of quality, origin etc. This strategy could have the following main characteristics:

(1) The co-financing and the granting of technical aid to the less developed Member States so that they can set up test laboratories in their main sectors of production,
(2) The imposition of a common European quality standard (or signs) that will be given (to the various products) by recognised national organisations,
(3) The creation of an independent Community organ for the mutual recognition of laboratory tests, quality signs and control and certification organisations in the Member States.

Definite progress must be made in the following areas in order to realise the objective of an Internal Market by 1992 as laid down in the Single Act:

(1) Public contracts must be open to producers of all Member States,

(2) Indirect taxation must be harmonised and approximated,

(3) Progress on standardisation must be continued,

(4) The financial dimension of the internal market must be completed. Capital movements must be liberalised. This move towards the inter-linking of financial markets will afford much wider opportunities for the circulation of securities, the development of collective forms of investment, access for borrowers to the capital markets of other Member States, and the quotation of securities on other stock exchanges.

10. Transport Policy

Complete freedom of movement of goods and persons can make full economic sense, only if transport policy makes substantial progress towards a genuinely competitive system enabling unit costs to be reduced significantly; travel within Europe must be made easier, while maintaining high quality and safety standards and adequate welfare rules. Action in the area of competition will not in itself offset handicaps affecting some areas and regions, either because they are far from communication routes or because they are congested by excessive traffic. Thus, transport policy has also a regional dimension.

Certain infrastructures must be created, the financing of which must in part be undertaken by the Community (EIB, ERDF and IMP) and in part by greater mobilisation of private money.

So, transport policy must move along the following main lines:

(1) More competition,

(2) More deregulation,

(3) Amelioration of infrastructure for less developed regions. Financial engineering techniques should be used from 1987 onwards to create conditions favourable to the planning and realisation of major projects (such as the Channel Tunnel) and to mobilise the market for new forms of Community funding (budget guarantees and project financing).

11. Research and Technological Development

The Single Act provides a legal basis for giving a new impetus to the Community's scientific and technological base.

Research and technological development is a decisive area for the creation of a large, modern and competitive market, an area in which it is becoming increasingly clear that the Community has a specific and indispensable role to play. Unfortunately, the actual situation in the Community is not very good. There is a great dispartiy in GDP expenditure for research between the Community and the US and Japan. In 1981 the US gave 2,5% and Japan 2,3% of their respective GDP's for research, compared to the Community's average of only 1,4%. Another disadvantage of Community research spending, is that since most of it is undertaken at the national level, duplication of effort is unavoidable.

Inside the Community a great disparity of R and D spending can be observed. In 1981 Germany spent 253,6, France 198,3 and the UK 203 US Dollars per head for R and D, (compared to 320,6 in the US and 217,4 in Japan) while Greece only 10,5, Portugal 15,8, Spain 24,1 and Ireland 45,1. In percentages of GDP, the situation is as follows: Community average 1,4, Germany, 1,8, France 1,5, UK 1,9, Greece 0,2, Spain 0,4, Portugal 0,5, Ireland 0,7. Community spending reached only 0,97% of the sum of national spending[18].

The Community would be the ideal instrument to bridge the inequality on R and D spending of the Member States. This inequality results in further future inequality, since R and D is very important for growth. (According to economic estimates more than 50% of yearly growth in the developed economies is due to technical progress, i.e. research and development that is implemented in innovations). Inequality in R and D spending is thus a source for the perpetuation of GDP and incomes inequality in the Community. R and D has a dual character, being both a result (low GDP leads to low R and D spending) and a cause of inequality (low R and D today leads to lower GDP in the future.)

R and D should be undertaken more and more at the Community level in future, because the Community offers the following advantages in this sector:

(1) R and D activity among Member States can be coordinated through the Community,
(2) Duplication of effort can be avoided
(3) Economies of scale exist in this field to a high extent, since this R and D is very capital intensive,
(4) A long-term strategy could be developed at the Community level that promises success, (such a successful strategy was developped by Japan in the past).

The Community's framework programme aims at

(1) the reinforcement of the industrial competitiveness of the Member States, and
(2) the reinforcement of cohesion, through the participation of less-developped Member States and small and medium sized enterprises to the programmes.

Conditions for the implementation of a successful R and D strategy for Europe are:

(1) The substantial increase of resources devoted to it at the Community and the national level,
(2) The financing of the programmes of the less-developped Member States with a higher than average percentage (even above 50% of the total cost of a programme),
(3) The financing by the ERDF of a programme of research infrastructure,
(4) The support of the flow of information and transfer of technology to the less-developped Member States.

12. Financial resources

This is one of the problem areas of the Community since it is common knowledge that the own resources base is being eroded because the various components are growing less rapidly than economic activity.[19] What the Community needs today is budgetary security and this can be achieved by making two major changes to its financial resources:

(1) The first is to define the new ceiling on resources by reference to Community GNP. This is a better reflection of the Community's prosperity and financial strength than VAT. The new ceiling can be fixed, according to the Commission's proposal to 1.4% of GNP for 1992,

(2) The second change is to alter the make-up of resources within this ceiling, not only to achieve a better match between each country's budget contribution and its relative prosperity but also to provide a measure of flexibility.

According to the Commission's proposals the resources available within the limit of 1.4% of GNP, would be as follows: Customs duties, agricultural levies and revenue from VAT, representing 1% of the base actually subject to VAT. To these three traditional sources, a fourth 'new balancing' resource, must be added, according to the Commission's proposals. This will be calculated on an additional base, defined as the difference between GNP and the actual VAT base used for the 1% levy. The Commission wants to keep a fifth option open. This resource could be added between now and 1992 but without exceeding the 1.4% ceiling. One possibility might be a minimal stamp duty on financial transactions. It must be underligned that with the proposed ceiling corresponding to 1.4% of GNP the growth of own resources will not be higher than in the years 1980 to 1987. In fact it will be lower if one allows for the fact that existing liabilities will have to be absorbed within that ceiling[20].

The principal change in the system proposed by the Commission is the introduction of the additional base, which would seem to introduce an element of progressivity because the burden falling on each Member State would be related to its GNP. Nevertheless, the call-in rate applied to the additional base would be determined by the size of the gap between resources obtained from traditional sources and the Community's expenditure requirements for any one year or the other. The additional base resource does not therefore establish a direct correlation between a Member State's payment and its relative wealth[21].

There have been in the past other proposals for new own resources of the Community, like those in the MacDougall Report which are still worth examining.

The MacDougall report looks at a number of possible new own resources. The report notes that if VAT in each Member State were composed of two parts, a national rate and a Community rate as a 'piggy-back' rate added to the national rate, there would be a much more direct link between the Community and the taxpayer. Increases or decreases in the Community rate would have a direct affect on the tax and prices paid by consumers. Such an arrangement would also provide the Community with its own fiscal instrument for a counter-cyclical tax policy.

A Community 'piggy-back' VAT would have to be married with an extension of the Community's budget powers. Surpluses or deficits arising from counter-cyclical tax policies would be financed by borrowing or saving operations.

Other Community income sources considered by the MacDougall report are -

- A Community corporation tax which would have the effect of taxing, automatically, the enterprises which profit most from the integration of the Common Market. This would be on the basis of a tax-sharing arrangement with the Member States,
- For regional policy the report points out that disincentives by way of the taxation of economic activities in congested areas could be used to finance incentives for the development of activity in less developed regions. The 'push and pull' effect would result in limiting the budgetary expenditure required to strengthen convergence.
- MacDougall also refers to contributions for directly financing the budget based on Member States fiscal capacity or national accounts. This closely resembles the Commission's proposal for an 'additional base'.

In short the Commission's proposals are for the removal of anomalies (e.g. the exclusion of ECSC levy from traditional own resources); a redefinition of the VAT base; and in the interim the creation of a residual revenue source based on a formula which includes national GNP as a variable. The MacDougall report's proposals are wider ranging and are also aimed at strengthening macro-economic management at Community level.

13. Small and medium-sized undertakings

Faced with the challenge of making firms more competitive and developing Europe's technological potential, it is vital that the Community should do more to help business, particularly small ones, with an eye to completion of the internal market. Further, SMU's are very important especially in under-developped regions, where very often big enterprises are totally absent. SMU policy has thus also regional aspects. A successful SMU policy can bring about increased growth in less-developped regions and so increase economic and social cohesion.

The main objectives of a Community programme for SMU's should be:

(1) The reorientation of SMU's to new products, specialisation and the introduction of new technology and organisation also for traditional products,
(2) The amelioration of organisation of methods of economic and financial management and of the level of education and training of their staff,
(3) The support of cooperation among SMU's in order to achieve economies of scale in many areas (common orders for raw materials, production cooperatives, common advertising and selling, common services etc.)

These aims could be achieved through an integrated programme having the following points:

(1) Greater development of organisations giving technical aid and services to SMU's,
(2) A system of diffusion of information in technology and knowledge for SMU's,

(3) Supporting the development and application of operational programming inside SMU's,

(4) Operating of incentives for the creation of common services for SMU's,

(5) Modernisation of economic and financial management of SMU's with the help of informatisation,

(6) Creation and development of 'modernisation centres' that would diffuse new technologies and knowledge, i.e. through the operation of model plants. They could at the same time diffuse also information from and to SMU's,

(7) Training of the staff of SMU's.

STATISTICAL ANNEX

Table 1

Integration effects on the % trend growth rate of member countries
- EECS 1961-72 -

Contributions to growth	Germany	France	Italy	Netherlands	Belgium-Lux.
Actual growth rate	4.39	5.40	4.97	5.17	4.56
1 - Growth rate due to EEC [1 = -2-3+4+5+6+7+8]	-0.02	-2.71	1.04	2.94	2.45
Which was made up of					
2-Terms of trade changes	0.02	0.57	0.94	0.19	-0.17
3-Change in propensity to import	2.25	2.90	1.12	0.44	1.16
4-Growth of export volume	3.52	1.25	4.74	4.09	4.56
5-Change in the trade balance position	-0.45	-2.08	0.05	-0.06	-0.71
6-Net EEC budget payments	-0.14	0.01	-0.28	0.12	0.09
7-Foreign investment	-1.02	-0.05	-1.13	-0.15	-0.07
8-Residual + errors [8 = (1+2+3) (4+5+6+7)]	0.34	1.64	-0.28	-0.43	-0.43

Notes: As defined in the model a negative sign of the terms of trade means an improvement;
-The total effect may differ from the sum of its components due to rounding.

Source: A. J. Marques Mendes, "Economic Integration and Growth in Europe", Croom Helm, 1987

Table 2

Table - Integration effects on the growth rate of member countries

- EEC8 1974-81 -

Contributions to growth	Germany	France	Italy	Netherlands
Actual growth rate	2.65	2.66	2.74	1.99
1 - Growth due to EEC [1 = -2-3+4+5+11+...+16]	0.91	1.57	0.42	0.53
Made up of				
2-Terms of trade changes	-0.01	-0.39	0.05	0.07
3-Change in propensity to import	0.88	0.79	0.40	0.29
4-Growth of exports of manufactures	0.02	0.30	0.07	2.33
5-Change in the trade balance of manufactures	0.74	0.66	-0.83	-2.66
6-Growth of exports of food products	0.50	1.35	0.14	1.28
7-Change in the trade balance of food	-0.44	-1.20	-0.35	-0.47
8-Export gains due to increased prices of food	0.02	-0.07	-0.10	-0.63
9-Change in the balance of price effects	-0.24	0.08	0.09	0.07
10-Net CAP - budget payments	-0.05	0.08	0.06	0.26
11 - total CAP effects [11=6+7+8+9+10]	-0.21	0.23	-0.15	0.51
12-Net non-CAP budget payments	0.06	0.02	0.20	0.03
13-Labour remittances	..	..	.08	..
14-Direct foreign investment	0.35	0.03	-0.04	-2.53
15-Interdependence effect	-0.25	0.01	0.47	1.71
16-Residual + errors [16 = (1+2+3)-(4+5+11+...+15)]	1.06	0.72	1.06	1.49

Notes:

- As defined in the model a negative sign of the terms of trade means an improvement,

-The total may differ from the sum of its components due to rounding;

- Appropriately the CAP total should also include effects on the terms of trade and propensity to import. The total CAP effects are therefore likely to be upward/downward biased.

- Trade estimates for the Netherlands are substantially upward biased for reasons referred to in the previous chapter (entrepot trade and home market).

Table 2 (cont.) - Integration effects on the growth rate of member countries

- EEC8 1974-81 -

Contributions to growth	Belgium-Lux.	U.K.	Ireland	Denmark
Actual growth rate	2.03	1.24	3.84	1.98
1 - Growth rate due to EEC [1 = -2-3+4+5+11+ ... +16]	0.71	0.37	0.31	-0.64
Made up of				
2-Terms of trade changes	-0.22	-0.31	0.32	-3.09[1)]
3-Change in propensity to import	0.57	0.32	3.28	0.21
4-Growth of exports of manufactures	0.27	0.79	2.38	-0.08
5-Change in trade balance of manufactures	0.74	0.50	-1.72	-2.86
6-Growth of exports of food products	0.42	0.65	1.12	0.78
7-Change in the trade balance of food	0.01	-1.98	-0.50	-0.46
8-Export gains due to increased prices of food	-0.13	-0.03	-0.38	-0.17
9-Change in the balance of price effects	-0.12	-0.04	0.36	0.12
10-Net CAP - budget payments	0.06	-0.32	0.86	0.19
11 - total CAP effects [11=6+7+8+9+10]	0.24	-1.72	1.47	0.45
12-Net non-CAP budget payments	0.09	0.08	0.54	-0.04
13-Labour remittances	..	.	..	.
14-Direct foreign investment	-0.02	0.09	0.20	0.89
15-Interdependence effect	0.19	-0.48	1.37	-0.73
16-Residual + errors [16=(1+2+3)-(4+5+11+...+15)]	-0.45	1.14	-0.32	-1.58[1)]

Note: 1) - Estimated without considering total capital flows in expression 3.44

Source: A. J. Marques Mendes, "Economic Integration and Growth in Europe", Croom Helm, 1987

Table 3

GDP at current prices per head (in ECU)

	B	DK	D	GR	E	F	IRL	I	L	NL	P	UK	EUR 12	USA	JA
1960	1 157	1 231	1 231	399	357	1 245	591	700	1 574	964	260	1 303	981	2 658	447
1961	1 211	1 341	1 371	441	399	1 330	633	766	1 545	1 034	277	1 364	1 060	2 680	542
1962	1 285	1 498	1 483	465	455	1 455	680	853	1 603	1 105	295	1 413	1 144	2 836	595
1963	1 372	1 582	1 557	517	531	1 603	727	970	1 692	1 182	318	1 493	1 238	2 951	680
1964	1 522	1 795	1 694	578	591	1 760	823	1 054	1 910	1 373	343	1 616	1 356	3 109	796
1965	1 642	2 000	1 831	655	680	1 877	873	1 126	1 979	1 512	383	1 723	1 462	3 328	869
1966	1 754	2 177	1 929	724	778	2 016	917	1 212	2 065	1 625	420	1 828	1 565	3 605	1 000
1967	1 878	2 361	1 958	776	850	2 171	982	1 332	2 081	1 771	472	1 894	1 655	3 795	1 165
1968	2 072	2 512	2 178	869	851	2 424	997	1 485	2 350	2 012	540	1 850	1 784	4 246	1 414
1969	2 309	2 862	2 468	990	965	2 632	1 153	1 640	2 726	2 267	598	1 980	1 972	4 573	1 654
1970	2 562	3 139	2 976	1 109	1 066	2 715	1 289	1 834	3 170	2 513	669	2 165	2 199	4 745	1 922
1971	2 809	3 408	3 359	1 190	1 177	2 949	1 452	1 959	3 212	2 829	747	2 405	2 427	4 957	2 118
1972	3 225	3 876	3 734	1 263	1 382	3 354	1 648	2 111	3 686	3 215	848	2 535	2 688	5 032	2 538
1973	3 770	4 641	4 517	1 467	1 656	3 910	1 750	2 287	4 576	3 821	1 039	2 606	3 083	5 059	3 107
1974	4 538	5 287	5 146	1 759	2 109	4 250	1 876	2 589	5 692	4 607	1 233	2 923	3 511	5 594	3 507
1975	5 088	6 000	5 447	1 858	2 381	5 181	2 131	2 794	5 284	5 137	1 270	3 359	3 926	5 769	3 617
1976	6 076	7 324	6 475	2 201	2 693	5 934	2 319	3 024	6 403	6 190	1 443	3 612	4 488	7 030	4 460
1977	6 915	8 007	7 366	2 463	2 906	6 325	2 666	3 376	6 925	7 086	1 475	3 955	4 962	7 607	5 330
1978	7 573	8 691	8 199	2 633	3 134	6 989	3 071	3 666	7 709	7 737	1 439	4 491	5 475	7 583	6 660
1979	8 056	9 404	9 037	2 947	3 848	7 816	3 511	4 216	8 368	8 191	1 505	5 392	6 179	7 760	6 363
1980	8 591	9 321	9 517	2 991	4 074	8 758	4 072	5 049	8 985	8 623	1 825	6 808	6 908	8 239	6 527
1981	8 725	10 049	9 937	3 414	4 470	9 505	4 769	5 627	9 394	8 925	2 157	8 113	7 554	11 454	8 914
1982	8 757	11 126	10 911	3 983	4 867	10 181	5 521	6 275	9 607	9 860	2 373	8 739	8 218	13 410	9 347
1983	9 159	12 320	11 981	3 986	4 660	10 619	5 836	7 025	10 505	10 383	2 306	9 054	8 713	15 726	11 112
1984	9 784	13 444	12 749	4 309	5 325	11 328	6 345	7 774	11 743	10 835	2 411	9 541	9 349	19 504	13 275
1985	10 561	14 949	13 455	4 325	5 781	12 212	6 926	8 256	12 808	11 320	2 683	10 483	10 021	21 237	14 527
1986	11 443	16 166	14 785	3 847	6 135	12 934	7 583	9 052	14 175	11 842	2 860	10 333	10 618	18 092	15 875
1987	11 886	17 043	15 601	3 920	6 322	13 374	7 997	9 750	14 952	12 076	2 938	10 966	11 148	18 995	17 091

Source: European Economy, No 29, July 1986

B. Gross domestic product at market prices (N1)

B.4 Per head of total population

	1960	1965	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
	At current prices and current purchasing power parities — Aux prix et parités de pouvoir d'achat courants																
	PPS / SPA																
EUR 10	1 073	1 585	2 364	2 606	2 874	3 279	3 728	4 227	4 911	5 533	6 210	7 053	8 007	8 813	9 728	10 687	11 414
D	1 224	1 823	2 661	2 916	3 220	3 634	4 088	4 639	5 449	6 208	6 958	7 962	9 065	10 039	10 983	12 027	13 089
F	1 053	1 601	2 460	2 763	3 094	3 503	4 036	4 625	5 361	6 051	6 844	7 753	8 786	9 704	10 822	11 691	12 475
I	839	1 280	2 065	2 241	2 451	2 822	3 281	3 612	4 217	4 727	5 267	6 067	7 091	7 836	8 562	9 154	9 906
NL	1 117	1 622	2 591	2 869	3 130	3 521	4 075	4 644	5 369	6 030	6 683	7 483	8 439	9 199	9 935	10 772	11 536
B	1 040	1 570	2 403	2 668	2 987	3 415	3 981	4 492	5 234	5 797	6 494	7 292	8 535	9 291	10 383	11 172	11 984
L	1 605	2 058	3 321	3 341	3 775	4 557	5 572	5 315	6 074	6 584	7 370	8 402	9 453	10 262	11 363	12 528	14 193
UK	1 263	1 746	2 377	2 609	2 838	3 295	3 666	4 190	4 813	5 386	6 068	6 822	7 505	8 174	9 138	10 162	10 920
IR	669	972	1 463	1 612	1 805	2 015	2 322	2 771	3 067	3 616	4 164	4 646	5 344	5 993	6 572	7 024	7 702
DK	:	:	2 765	3 032	3 386	3 779	4 187	4 759	5 610	6 274	6 910	7 860	8 805	9 654	10 940	12 048	13 240
GR	393	691	1 172	1 347	1 551	1 795	1 936	2 337	2 720	3 058	3 507	3 948	4 492	4 906	5 355	5 758	6 210
ESP	:	1 046	1 650	1 845	2 108	2 442	2 874	3 303	3 728	4 199	4 609	5 034	5 720	6 299	6 928	7 609	8 181
POR	352*	577*	975	1 120*	1 296*	1 560*	1 736*	1 851*	2 138*	2 489	2 784	3 251	3 796	4 192	:	:	:
USA	1 805	2 590	3 511	3 843	4 273	4 844	5 345	6 036	6 938	8 003	9 024	10 086	11 191	12 668	13 401	14 717	16 530
JAP	:	1 116	2 197	2 432	2 757	3 167	3 463	4 031	4 632	5 329	6 053	6 929	8 098	9 233	10 397	11 460	12 604*
	At 1980 prices and 1980 purchasing power parities — Aux prix et parités de pouvoir d'achat de 1980																
	PPS / SPA																
EUR 10	4 297	5 176	6 267	6 424	6 643	6 998	7 083	6 988	7 327	7 473	7 705	7 951	8 007	7 968	7 990	8 070	8 226
D	4 896	5 946	7 048	7 177	7 432	7 743	7 754	7 659	8 112	8 369	8 620	8 973	9 065	9 063	9 011	9 151	9 424
F	4 220	5 232	6 527	6 816	7 155	7 479	7 670	7 650	7 997	8 185	8 496	8 739	8 786	8 777	8 886	8 911	8 993
I	3 362	4 182	5 479	5 533	5 669	6 026	6 235	5 975	6 296	6 390	6 538	6 839	7 091	7 092	7 038	6 984	7 142
NL	4 477	5 303	6 877	7 079	7 239	7 517	7 755	7 681	8 008	8 145	8 295	8 435	8 439	8 321	8 167	8 213	8 308
B	4 165	5 131	6 370	6 581	6 901	7 287	7 564	7 430	7 808	7 831	8 059	8 218	8 535	8 402	8 627	8 517	8 640
L	5 850	6 632	7 653	7 814	8 231	8 853	9 100	8 485	8 643	8 785	9 095	9 353	9 453	9 297	9 366	9 616	10 083
UK	5 067	5 709	6 300	6 437	6 564	7 048	6 980	6 933	7 196	7 274	7 537	7 696	7 505	7 391	7 508	7 756	7 878
IR	:		3 879	3 976	4 170	4 297	4 407	4 579	4 569	4 878	5 162	5 236	5 344	5 415	5 396	5 355	5 548
DK			7 335	7 479	7 828	8 064	7 952	7 876	8 365	8 475	8 674	8 855	8 805	8 729	8 985	9 181	9 540
GR	1 575	2 258	3 109	3 316	3 587	3 833	3 679	3 865	4 057	4 133	4 353	4 458	4 492	4 437	4 402	4 389	4 477
ESP	:	3 419	4 379	4 553	4 880	5 216	5 462	5 464	5 563	5 678	5 716	5 676	5 720	5 700	5 689	5 804	5 898
POR	1 412*	1 887*	2 595*	2 770*	3 001*	3 327*	3 306*	3 072*	3 199*	3 365*	3 457*	3 666*	3 796*	3 792*	:	:	:
USA	7 229	8 462	9 311	9 480	9 882	10 342	10 157	9 983	10 354	10 813	11 205	11 369	11 191	11 453	11 002	11 220	11 915
JAP	:	3 644	5 810	5 978	6 356	6 736	6 565	6 651	6 894	7 189	7 487	7 809	8 092	8 344	8 622	8 726	9 120*

Table 4 (cont.)

1960	1965	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	
At current prices and current exchange rates — Aux prix et taux de change courants																	
ECU																	
1 081	1 597	2 399	2 647	2 921	3 339	3 774	4 225	4 839	5 368	5 942	6 670	7 485	8 180	8 901	9 519	10 176	EUR 10
1 215	1 831	2 976	3 359	3 734	4 517	5 146	5 447	6 475	7 366	8 199	9 037	9 517	9 937	10 911	11 981	12 749	D
1 245	1 877	2 715	2 949	3 354	3 910	4 250	5 181	5 934	6 325	6 989	7 816	8 758	9 505	10 181	10 619	11 328	F
700	1 126	1 834	1 959	2 111	2 287	2 589	2 794	3 024	3 376	3 666	4 216	5 049	5 627	6 275	7 025	7 774	I
908	1 424	2 513	2 829	3 215	3 821	4 607	5 137	6 190	7 086	7 737	8 191	8 623	8 925	9 860	10 383	10 835	NL
1 157	1 642	2 562	2 809	3 225	3 770	4 538	5 088	6 076	6 915	7 573	8 056	8 591	8 725	8 757	9 159	9 784	B
1 574	1 979	3 170	3 212	3 686	4 576	5 692	5 284	6 403	6 925	7 709	8 368	8 985	9 394	9 607	10 505	11 743	L
1 303	1 723	2 165	2 405	2 535	2 606	2 923	3 359	3 612	3 955	4 491	5 392	6 808	8 113	8 739	9 054	9 541	UK
591	873	1 289	1 452	1 648	1 750	1 876	2 131	2 319	2 666	3 071	3 511	4 072	4 769	5 521	5 836	6 345	IR
:	.	3 139	3 408	3 876	4 641	5 287	6 000	7 324	8 007	8 691	9 404	9 321	10 049	11 178	12 385	13 587	DK
399	655	1 109	1 190	1 263	1 467	1 759	1 858	2 201	2 463	2 633	2 947	2 991	3 414	3 983	3 986	4 309	GR
:	680	1 066	1 177	1 382	1 656	2 109	2 381	2 693	2 906	3 134	3 848	4 074	4 478	4 850	4 667	5 332	ESP
277*	403*	707*	786*	893*	1 092*	1 297*	1 340*	1 520*	1 559	1 520	1 590	1 927	2 277	:	:	:	POR
2 647	3 314	4 720	4 936	5 016	5 045	5 579	5 755	7 013	7 588	7 565	7 741	8 222	11 426	13 378	15 689	19 456	USA
:	870	1 928	2 119	2 548	3 108	3 509	3 618	4 461	5 333	6 663	6 365	6 529	8 918	9 349	11 116	13 203*	JAP
At 1980 prices and 1980 exchange rates — Aux prix et taux de change de 1980																	
ECU																	
4 033	4 858	5 866	6 017	6 226	6 551	6 625	6 541	6 857	6 996	7 213	7 440	7 485	7 448	7 471	7 550	7 695	EUR 10
5 140	6 243	7 399	7 535	7 803	8 129	8 140	8 040	8 516	8 787	9 050	9 420	9 517	9 514	9 460	9 607	9 894	D
4 206	5 215	6 506	6 794	7 132	7 455	7 646	7 625	7 971	8 159	8 468	8 711	8 758	8 749	8 858	8 882	8 964	F
2 394	2 978	3 901	3 940	4 037	4 291	4 440	4 255	4 483	4 550	4 656	4 870	5 049	5 050	5 012	4 974	5 086	I
4 575	5 418	7 027	7 234	7 397	7 681	7 924	7 849	8 183	8 323	8 476	8 618	8 623	8 503	8 345	8 392	8 489	NL
4 192	5 164	6 411	6 624	6 946	7 334	7 612	7 478	7 858	7 882	8 111	8 271	8 591	8 456	8 582	8 572	8 696	B
5 560	6 303	7 274	7 427	7 823	8 415	8 649	8 065	8 215	8 350	8 644	8 890	8 985	8 837	8 902	9 139	9 584	L
4 596	5 178	5 715	5 839	5 955	6 394	6 331	6 289	6 528	6 598	6 837	6 981	6 808	6 705	6 811	7 036	7 146	UK
:	:	2 955	3 029	3 177	3 274	3 357	3 488	3 481	3 716	3 933	3 989	4 072	4 125	4 111	4 079	4 227	IR
:	:	7 765	7 917	8 287	8 536	8 418	8 338	8 855	8 972	9 076	9 374	9 321	9 240	9 511	9 719	10 098	DK
1 049	1 504	2 071	2 208	2 389	2 552	2 450	2 574	2 702	2 752	2 899	2 969	2 991	2 955	2 931	2 923	2 982	GR
.	2 435	3 118	3 243	3 476	3 715	3 890	3 892	3 962	4 044	4 071	4 042	4 074	4 060	4 052	4 134	4 200	ESP
716*	958*	1 317*	1 406*	1 523*	1 689*	1 678*	[illegible]	1 623*	1 708*	1 764*	1 860*	[illegible]	1 924*	.			POR
5 311	6 217	6 841	6 966	7 260	7 599	7 463	7 336	7 607	7 846	8 233	8 363	8 722	8 416	8 084	8 744	8 766	USA
.	2 938	4 685	4 820	5 124	5 431	5 293	5 362	5 559	5 796	6 037	6 296	6 524	6 727	6 871	7 035	7 363*	JAP

Source: EUROSTAT, National Account Aggregates, 1960-1984

NOTES

[1] See Verdoorn, P.J., "Measuring Integration Effects: A survey", in European Economic Review, 1972, p. 337-349, and the papers in Bela Balassa, ed. "European Economic Integration", North Holland Publishing Company, Amsterdam, 1975.

[2] The assumptions of custom unions theory are: (a) The many commodities being produced can be reduced to two composite goods; (b) The immobility of factor inputs at the international level; (c) A given and perfectly known technolocy; (d) Perfect competition; (e) Constant return to scale; (f) Consumers are utility maximizers with given preferences; (g) Their consumption plans derive exclusively from income generated from domestic production; (h) The balance of payments adjusts automatically without significant costs; (i) Constant exchange rates; (k) The given preferences are represented by convex and non-intersecting indifference curves (monotonicity assumption).

[3] For some criticism see A.J. Marques Mendes, "Economic Integration and Growth in Europe", Croom Helm, 1987.

[4] Thirwall, A.P., "The Balance of Payments Constraint as an Explanation of International Growth Rate Differences", Banca Nazionale del Lavoro, Quarterly Review, 45-53, 1979; Thirwall, A.P., "The Harrod Trade Multiplier and the Importance of Export-led Growth", Pakistan Journal of Applied Economics, 1982 Marques Mendes, A.J., 1987 and Marques Mendes A.J, "The contribution of the European Community to Economic Growth", Journal of Common Market Studies, Vol. XXIV, No 4, June 1986.

[5] Marques Mendes, A.J., 1986 and 1987.

[6] Marques Mendes, A.J., 1987, p. 104.

[7] J. Delors to the European Parliament reprinted as "Introduction of the Commission's programme for 1987", in Bulletin of the EC, Supplement 1/87.

[8] For a review of trade diversion/creation methodology studies see Erik Thorbercke, Emilio Pagoulatos, "The effects of European Economic Integration on Agriculture", in B. Balassa, 1975, for other methodologies see A. J. Marques Mendes 1987 and "Agricultural Policies in the EC", policy monograph No 2 and "Interesectoral effects of the CAP" occasional paper No 95, both by the

Bureau of Agricultural Economics, Australia, Canberra 1985.

[9] A. J. Marques Mendes 1987.

[10] Bulletin of the EC, Supplement 1/87, "The Single Act: A new frontier for Europe".

[11] The MacDougall Report, formally entitled "The Report of the Study Group on the Role of Public Finance in European Integration", was published by the Commission as No A13 in its Series of Economic and Financial Studies in 1975 and was prepared by a group of academic experts chaired by Sir Donald MacDougall, then Chief Economic Advisor of the Confederation of British Industry. The Report examines the future role of public finance at Community level in the general context of European economic integration. Its conclusions are based on a detailed study of public finance in five existing federations and three unitary states.

[12] Directorate General for Research of the EP "Regional Policy Expenditure in the EC and its Member States", 20 February 1987, and "Convergence and Cohesion", 17 March 1987.

[13] Report for the Committee on Regional Policy Doc. A2-205/87 of 8.11.87.

[14] For an extensive presentation of the arguments for and against fixed exchange rates, economic and monetary independence and the advantages and disadvantages of the EMS, see N. Kyriazis "The drachma's adhesion to the EMS: possible effects" in "Kredit und Kapital", Heft 4, 1985 and N. Kyriazis "The drachma's adhesion to the EMS", Research and Documentation Papers of the EP, Economic Series, No. 5, May 1983 and the literature cited in these two papers.

[15] N. Kyriazis, N. Chryssanthou, "US-EC Monetary Relations", Research and Documentation Papers of the EP, Economic Series No. 8, 2nd edition, November 1986, and papers cited therein.

[16] There exists extensive literature on monetary unification. See for example the papers on M. Fratianni and J. Peeters, Editors, "One money for Europe", McMillan, London 1978.

[17] For a more extensive treatment of this topic and a proposal to reform the international monetary order through a tripolar Dollar-EEC-Yen arrangement, see N. Kyriazis, N. Chryssanthou "US-EC Monetary Relations", cited above.

[18] "Einige Angaben zum Vergleich der Forschungsausgaben in der Mitgliedsländern der Gemeinschaft und in der USA und Japan", Directorate General for Research, 25.3.1987.

[19] For a more extensive discussion of this topic, see Bulletin of the EC, SUpplement 1/87 pp. 17-23

[20] Delors to the EP, 18.2.1987

[21] Directorate General for Research, "Own resources and future financing", 26.3.1987

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