1992 — A MARKET EUROPE OR A SOCIAL EUROPE?

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The year 1992 has become a most eagerly anticipated date. For many businessmen and politicians it promises a miracle; others fear a 'fiasco'. Even those who accept that what will happen in 1992 will be beneficial would like to make quite sure that 1992 only means what they think it does; they fear a hijacking of the concept by others. A Europe of deregulation and free movement of goods and services, a Thatcherised Europe is predicted; on the other hand a social Europe with equal guarantees of workers' rights is feared. Will 1992 usher in a single European domestic market, free of all interference, national or European, or will it be harmonised by the Brussels bureaucracy?

In this brief paper I hope to clarify what the different definitions and visions of 1992 entail and why, disparate though they may seem, they have to be taken together if we are to do justice to the complexity of the forthcoming changes. The economic theory behind the forecast that it will benefit Europe is a well-known but static argument in trade and welfare theory. This said, we have to bear in mind that the time-frame within which the benefits predicted by economic theory will be realised is vague — it could take years or decades. The dynamic effects during the transition from the present to the future integrated market are not known with any certainty except that they will occur soon. Above all, the uneven development of the various economies which form the European Community (EC) poses special problems when it comes to economic integration. We have already seen how the UK government hopes that the single market will not lead to a single currency area, much less a single political federation; the Germans and the French disagree and hope to hasten such an outcome.

Thus, on the one hand we have the promise of a fully integrated European Domestic Market (EDM), free from all barriers, which it is hoped will bring an immediate benefit to consumers and producers. At the same time, as European nations progress towards 1992, doubts persist and increase about the desirability of such a rapid move and about what may come after. In speaking of Europe, one is of course speaking of the

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European Community known as the Common Market. The two progenitors of the Common Market are the Benelux customs union and the European Iron and Steel Community. One represents the ideal of a customs barrier-free area in which similar economies can trade. The other represents the dirigiste notion of a cartel with planning and market-sharing. Both are aimed at securing economic growth but represent conflicting philosophies. At the heart of the Common Market, this tension between free trade/free market and orderly planning/bureaucracy has persisted.

Starting from the Treaty of Rome in 1960, by the time the twenty-fifth anniversary of the Common Market had come, the Community had expanded from the original six to ten and was about to admit two more. By this time for each country in the EC, trade with other members was more important than with any country outside the EC. Total intra-EC trade is quoted at 450 billion ecu (£300 billion) in 1987 (Pelkmans and Winters, 1988). There is a total market of 320 million people. Despite these favourable features, there were a number of problems.

First, there was a clear realisation that despite its old title, the EC was not a common market. There were innumerable barriers to movements of goods and people across the frontiers. Second, it seemed that, conceived in very optimistic days, the EC had stopped growing in economic terms. Indeed, the entry of the UK in the EC in 1973 coincided with the OPEC oil shock and OECD countries faced ten years of economic slowdown. In the late 1970s, Eurosclerosis became a catchphrase. Europe faced stagflation and deindustrialisation. In this context, the popularity of the Common Market was eroded by the Common Agricultural Policy (CAP). For citizens of the EC, the butter mountains and wine lakes caused by the CAP were a sure sign of a bureaucratic/political failure. For the Commissioners and the Council of Ministers, the fact that CAP absorbed three quarters of the Community budget was a problem. Either way, a more postive slogan was needed. Third, through the 1970s and early 1980s the climate of economic thinking had changed towards market-oriented, liberal policies. From being conservative and cautious, laissez-faire had emerged as a radical doctrine. The onus of proof was on the interventionist and not on the free marketeer when it came to arguments about trade liberalisation. Lastly, the widening of the Community meant a diluting of the old single market has been costing European industry millions in unnecessary costs and lost opportunities; that the completion of the Internal Market will provide the economic context for the regeneration of European industry in both goods and services; and that it will give a permanent boost to the prosperity of the people of Europe and indeed of the world as a whole.' (Cecchini, 1988, p.xiii.)

The three prongs in Lord Cockfield's statement are costs of existing situation, benefits to European industry and benefits to people (i.e. consumers) of Europe and the world. Of these three prongs, there has been an attempt to provide evidence on costs of the present situation. The main source here is the Cecchini report on the 'costs of non-Europe'. This is a report on a large study, some part of which are yet to come out. But *1922: The Benefits of a Single Market* by Paolo Cecchini, and *The Economics of 1992* by Michael Emerson are two crucial documents. I shall look at the findings of these studies below.

When it comes to benefits from moving to an internal market, there is nothing concrete. A faith in neoclassical economic theory, especially the static theory of trade and welfare, is required to assert that removal of the barriers and the distortions would automatically lead to benefits. Since most of the complaints about the lack of a common market have come from businessmen, it is possible to argue that if the businesses don't have to bear the costs of the many barriers, they cannot but benefit. The benefits to the consumers are predicted from invoking economic theory. When I come to assessing the benefits, the possible drawbacks of this body of theory will be discussed.

Much of the literature on achieving the EDM is very naive about the political problems involved. It is felt that the benefits are so obvious and so overwhelming that politicians will be forced by their voters to speed up implementation. It is already clear, four years before the completion date, that there are major differences of interpretation and approach among the various participants. While Lord Young, the UK Secretary of State for Trade and Industry, forecasts Thatcherisation of Europe, he is contemptuous of harmonization and of the EC Commission President Delors' insistence on a social Europe. There is a problem here. As *The Times* said in its editorial on March 11, 1989, 'Lord Young is right to insist on the primacy of economic dynamism and open competition: the success of the single market depends on it. But there is no escaping political facts. It is precisely because, to many Europeans, 1992 is a step towards political integration and incorporates in M. Delors' words, concepts of "cooperation" and "solidarity" that Mrs Thatcher's speech in Bruges last year was important'.

It is the political dangers and problems that must be borne in mind when assessing whether the goals set out in the 1985 White Paper will be attained by the end of 1992. The shape that the EC will take in the 1990s is not at all certain, as I shall argue in a later section.

Costs of the unCommon Market

The costs of the present arrangements are classified mainly as *barriers* to free movements of goods, services and factors and *distortions* caused by policies pursued by the several member governments. In the Cecchini report the costs are listed under the following headings.

(i) Red-tape and border-related controls. These prevent or make costlier the movement of goods across the national boundaries rather than within the boundary. A suggested example is that a consignment by road from London to Milan takes 58 hours for a lorry driver, while London to Glasgow, the same distance of 750 miles, takes only 36 hours. Border checks, form-filling formalities, differences in VAT rates, transport controls — all these factors enter here. At 2-5 per cent of trade volume, the costs come to 5 to 12 billion ecus (£3-8 billion).

(ii) Government protectionism in procurement markets. Public sector procurement is estimated at 530 billion ecus. Since usually only local producers can tender for such contracts, the Cecchini report estimates that costs are higher than they would be if international competitive tendering was allowed. Only about 5 billion ecus worth of contracts go to other EC countries. The report says that the static trade effect (buy the cheapest), the competition effect (downward pressure on prices) and the restructuring effect (inefficient firms forced to reorganise) sum to 17.5 billion ecus (£11-12 billion).

(iii) Divergence in technical regulations and standards. This lead to proliferation of product designs to meet different technical requirements, to small production runs thus losing economies of scale, loss of competitiveness since the national markets are narrow. Costs are not quantified in this respect.

(iv) National competition policy (protective of local industries). Price discrimination in favour of local manufacturers, state aid to industries, quotas or variable export restraints are the main issues here. The most notorious case here is car prices, where if a car costs 100 currency units in the UK, it costs 66 in Denmark, 80 in Belgium, 82 in Netherlands, 86 in Germany and France.

(v) Services and manufacturing. The next step in the Cecchini Report is to examine the distortions and barriers in the services industry. Here financial services (banking, insurance and brokerage), telecommunications and other business (R & D, legal, engineering, computing, etc.) are studied. Eliminating these distortions is assumed to lead to a fall in the price and the associated consumer surplus is measured. This comes to 21.7

billion ecu for financial services, and between 1 to 4 billion ecu for telecommunications. The Report then turns to certain selected manufacturing industries — telecommunications equipment (gains of 1 billion ecu from standardisation, 2-4 billion from liberalising procurement), automobiles (1.7 billion saving in fixed costs), foodstuffs (100 million ecu), building products (820 million ecu), textiles, pharmaceuticals, etc.

The total gain from removing all these barriers is estimated at 200 billion ecu or 4-7 per cent of GDP of EC in the long run. In estimating this, the report comes often to speak in terms which are almost poetry. '. . .(T)hese costs take various shapes but are essentially of two types: those which will be eliminated immediately once barriers are removed; and those, much more sizeable, which are economic efficiencies that will only be unravelled and replaced by more dynamic practices over time under the competitive pressures of the integrated EC market' (p.71). The microeconomic gains are consumer surplus but in adding these up, the approach is a partial equilibrium one. Thus the fact that price cutting may lead to profit squeeze and in some cases bankruptcies is not seriously considered on the minus side. The Report invokes the 'long run' to assert that all will be well.

Price subsidies and barriers also have macroeconomic consequences, usually assumed to be favourable. The Report however does not take these into account. Its macroeconomic optimism is no less fervent than its microeconomic one. 'The process is in essence simple. It starts with the lowering of production costs and with gains in productivity which will result from EC market integration. The ensuing price reductions will in turn have an important knock-on effect on the main mechanisms of the macro-economy. They will increase purchasing power; change the competitive positions of individual EC countries with each other and of the Community with the outside world; they will provide the basis for a durable attack on unemployment; stimulate demand yet reduce inflation; in short, they will provide an entirely new outlook — and trajectory — for economic growth between now and the end of the century' (p.27).

The Gains Evaluated

If I sound somewhat sceptical about it, it is for the simple reason that frequently in recent years the most practical of people have been carried away by the most abstract and unrealistic models of economic theory, only to discover much too late that the economists' 'long run' can be very long and indeed does not refer to calendar time at all, and in the meantime the short run costs are real. One such recent example is the monetarist experiment of the late 1970s to early 1980s in OECD countries, when it was argued that control of money supply would reduce inflation without any side-effects on employment or output. The prediction of large benefits and negligible costs from market integration comes from the same school of economics which made the monetarist predictions.

Once it is argued that barriers and distortions are costly, it often becomes natural to argue that their elimination is a necessary condition for efficient growth — indeed, to predict continual stagnation in their persistence. But take the discussion of barriers in financial services. The USA has enjoyed one of its stronger periods of economic growth in the 1929-79 period, with every tight restrictions on banking in the form of the Glass Steagal Act. There were strict barriers on banks' ability to move across state boundaries or to take part in certain financial markets. The American housing revolution was financed by a restrictive financial institution, the Savings and Loan Association, whom deregulation has hit so badly as to require a $50 billion rescue package. The Japanese economy, whose success and dynamism is undoubted, operates on corporatist rather than competitive principles.

The American example raises a fundamental problem for the EC market integration programme. Thus it has been argued that it is the fact that it is a single currency area with no customs barriers in the movement of goods that is important in the US case. The obstacles to standardisation of financial and professional services have been less important. But for the EC, a single currency area is a controversial question. While most EC economies are in the EMS, there is resistance, especially on the part of the UK which has stayed out of EMS currency arrangements for a single currency.

The controversy on the single currency area, to which I shall return later, points to some fundamental differences in the visions about EDM on the part of different European partners, that I referred to in the introduction. Thus one vision is of deregulation, privatisation, laissez faire and reduced state control. This is the Thatcherite vision. On the other hand, harmonisation of taxes and regulations, standardising product specifications and laying down uniform standards is also a form of market integration. Some of the costs listed above are due to lack of deregulation but others are due to lack of uniform regulations. The latter requires a strong central authority in Brussels, but this is thought to be contrary to the Thatcherite vision.

To some extent, the opposition by the UK is ingenuous. Within the UK, Mrs. Thatcher's policy of deregulation has been possible only because she has centralised the state more than before. As in the first experiment of laissez faire in England in the 1830s and 1840s, to liberate the economy requires a strong state. It is a weak state that is prey to lobbies and sectional interests. It will have to be deregulation and harmonisation, privatisation and standardisation in a dialectical relationship that is required to realise the EDM. (On the dialectical relationship between planning and markets see Auerback, Desai and Shamsavan, 'The Dialectics of Market and Plan: Transition from Actually Existing Capitalism', *New Left Review,* September-October 1986. Laissez faire is discussed in M. Desai, 'Men and Things', *Economica,* February 1986.)

All this is just to say that a simple adding-up of consumer surpluses to justify market integration is a narrow economistic approach; it misses out the political economy of market integration. It is to this that I now turn.

Some Political Economy of Market Integration

What are the global forces which are driving the moves towards EDM? The intra-European political need to find a unifying rallying cry is one factor, but that is only a proximate, not a real cause. One fact is the emergence of a global division of labour during the 1970s. In the twenty-five years following the Second World War, the technological revolution was embodied in the large industrial corporation with vertically integrated production. This form of enterprise relied on the guarantee of a buoyant domestic market for much of its sales, only exporting at the margin. Keynesian policies of maintaining high levels of effective demand via an expansionary fiscal policy and a loose monetary policy was suited to this era and the technology. There was export of capital, most notably by the USA, but this was the export of the total production technology to another location. Thus Ford UK and Ford USA were two separate completely integrated production facilities, owned by one financial entity. Each relied on its 'domestic' government for support.

It was the US example of a large domestic market which inspired early Western European efforts at the common market. In the UK as on the continent, the idea firmly took root that the US firms were more competitive and dynamic because their large internal market enabled them to realise economies of scale. It was the restricted fragmented internal markets of Europe's several economies that prevented these scale economies from being realised. European nations individually encouraged emergence of large firms (via the IRC in UK, and IRI in Italy, for example) and looked to larger markets domestically by the device of the common market.

But before the vision could be put into practice, the steam ran out of the Keynesian-Fordist revolution. For one thing, continued full employment had led to an exhaustion of the reserve army of unemployed, a rise in real wages well beyond the growth of productivity, and a fall in profitability. The ability of the nation state to maintain effective demand at high levels was no longer relevant since that added to the erosion of profitability via inflation. The consensual state could not maintain full employment and high growth rate while protecting profitability from erosion due to wage and price inflation.

The OPEC oil crisis of 1973 came on top of the profitablity crisis. Already by the early 1970s, declining profitability was compelling industrial capital in OECD countries to look for cheaper sources of labour and material supply. With the commodity price boom of 1972 and the oil price rise of 1975, the old large corporate enterprise had to seek new ways of maintaining profitablity. It was from this restructuring through the stagflation that the truly multinational corporation emerged. Now production is fragmented across national boundaries; the technological revolution in shipping containerisation and in communication makes such a division of labour across long distances commercially feasible. The globalisation of financial markets makes the financing of this capital mobility easy. To some extent, national boundaries are just an obstacle. The national governments which were guarantors of domestic markets are now protectors of the old integrated local capital against the new, internationally spread multinational capital.

The thrust for the new common market, for 1992, comes from this set of forces. On the one hand, the new capital is multinational and independent of local national government. On the other hand, as all economies are now open, the pressures of international competitiveness are very strong. By relocating away from one region, capital can evade local economies, cause unemployment and inflict budget deficits if the social transfer payments have to be maintained. The emergence of Japan as a major force in this game has increased the compulsion towards creating a territorially integrated EDM to defend local jobs. The agenda for a common market, first put together in the 1960s, has now come back due to very different reasons. It is a cost-cutting, rationalising capital selling all over the world rather than relying on a domestic market that needs EDM.

There is also however a protectionist edge to EDM vis-a-vis Japan, the USA and the newly industrialising countries (NICs). Free market internally and protection from foreign competition is an amalgam well known in Europe, since the days of Frederick List. It is only in as much as European capital also wishes to locate in USA and elsewhere that there is still a battle about how protectionist the EC can be. Different fractions of the European capital pull in different directions.

A central fact about the enlarged EC, as about any collection of modern economies, is that it is marked by uneven development. Within each country there is of course the range of enterprises from the multinational multi-enterprise conglomerate to the local small firm, as there is regional unevenness. But even at the level of national economies, there is a tremendous unevenness. The peripheral economies of Greece, Spain, Portugal and Ireland are much less developed than the core economies of West Germany, France and Benelux. Italy, Denmark and the UK are in between. The peripheral economies are low-wage, low-skill economies with interest in attracting capital from within the EC or abroad. Standardisation of products, health and safety legislation, stringent pollution control, are not to their liking. They need development in any form they can get. The high-wage, high-skill economies of the core wish to be protected against cheap labour products from the NICs or from the peripheral countries of the EC. Those in between are divided. The UK has a strong financial sector which is scandalously unregulated compared to, say, its counterpart in the USA. But the UK manufacturing industry is not at all confident that deregulation would help it. Thus the CBI and the Institute of Directors are often at odds within themselves, with each other and with the government. The EDM is not a challenge; it is a threat. This is why certain aspects of the EDM, such as harmonisation, are singled out for criticism.

The path to 1992 and beyond is thus not so straight forward as the simplicities of the Cecchini Report make it. It is very likely that the integration of the market may take much longer than anyone anticipates and its benefits may be smaller than expected and later in coming. But there is no going back for any individual member. The international division of labour and the globalisation of financial markets mean that a country going it alone will be even more subject to exogenous shocks than if it stayed in the EC. The reluctance of many member countries to face up to the dual dialectical logic of market integration — deregulation and harmonisation; downgrading of the autonomy of national monetary policies and the necessity of a single currency — may yet lead to a two-tier Europe. The core countries, the original six, may yet form a single-currency, single federal unit with coordinated majority decisions on all issues, with the peripheral latecomers being only associate members subscribing to EDM but not a single currency. An integrated market with independent multiple currencies is hard to envisage, as it has not happened anywhere in modern times. Taxes may not be harmonised as they are not in many federations; there may be barriers and obstacles to free expansion as in the case of US banking. But without a single currency an integrated market is difficult to conceive.

The question of 1992 and after thus remains open. Ideally everything will go smoothly; a true common market will emerge and be competitive and prosperous. But beyond that there are many differences as to what will be the concrete details of the EDM. The ambiguity is not wilful politicians' fault; it is inherent in the programme of the common market. Liberalism and dirigism, autonomy and centralisation, growth in the centre and stagnation at the periphery are all equally and simultaneously likely.

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