

The European Community: On the Road to Integration

The European Community has made important, though uneven, progress toward European unity during its first 30 years; its most significant life may lie ahead

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With the accession of Portugal and Spain on January 1, 1986, the European Community (EC) now includes 12 member states covering most of Western and Southern Europe (see "Evolution of the European Community," *Finance & Development*, September 1986). Its combined population, in excess of 320 million, makes it the world's largest trading bloc. In terms of GDP, the EC is second only to the United States. Established in 1957 by the six founding members of the European Coal and Steel Community, the EC has, in its first 30 years of existence, not only grown in size and influence but, by facilitating the process of economic integration between its members, also made a significant contribution toward strengthening European political unity, its original and foremost objective. The thirtieth anniversary of the signing of the Treaties of Rome establishing the various EC entities provides an appropriate occasion to review the Community's origins, its most important accomplishments and remaining weaknesses, and the prospects for the creation of a single unified economic entity within the next decade.

Early Days

Earlier calls for political unification in Europe, in the 1920s, had made little headway against the firm allegiance of most governments to the concept of inviolable and indivisible national sovereignty. It was only after World War II, with its attendant destruction and economic collapse, that governments appeared ready to begin to develop the mechanisms which would bring about a greater degree of cooperation among European nations. Indeed, cooperation and unity began to be perceived as es-

sential prerequisites for economic growth and prosperity.

The fundamental question was how to allow the German economy—with its key coal, iron, and steel sectors, so important in any war effort—to make a contribution to the recovery of Europe without jeopardizing its future peace. A plan, elaborated by Jean Monnet and put forward by Robert Schuman, the French Foreign Minister, on May 9, 1950, proposed the creation of a common market for Franco-German coal, iron, and steel products under a joint authority. Other countries were invited to participate in the creation of such a market and in April 1951 Belgium, France, Germany, Italy, Luxembourg, and the Netherlands signed a treaty establishing the European Coal and Steel Community (ECSC).

The main features of the ECSC were to place all coal, iron, and steel industries under the control of a supranational High Authority whose powers included the setting of production quotas for all member countries, the financing of retraining schemes for redundant workers, and the laying out of certain rules to prevent unfair competition. Important institutional provisions included the creation of a Council of Ministers empowered to take certain major decisions, a parliamentary assembly to add a measure of democratic control, and a European Court of Justice to ensure compliance with the provisions of the Treaty.

The establishment of the ECSC was not seen as an end in itself, but rather as a first step in a lengthy process which had the potential to lead toward greater economic and political integration. At about the time that the ECSC Treaty was signed, for instance, France proposed the creation of a European Defense Com-

munity to bring the armed forces of Europe under the control of a federal authority. As this would have entailed the existence of a common foreign policy, a proposal was considered by the members to create a new Community with powers in the areas of foreign affairs, defense, economic and social integration, and human rights. But the ensuing debate showed that there were significant differences among member states in the degree of commitment to the principle of integration and in the extent to which each was willing to cede sovereignty in specific areas.

The failure to establish a viable European Defense Community, however, convinced the ECSC countries that European integration would have to proceed with less ambitious objectives in mind. To this end the Foreign Ministers of the ECSC countries appointed a committee—under the chairmanship of Paul-Henri Spaak, the Belgian Foreign Minister—to look into the issue of further integration and, in mid-1956, the committee's proposals were approved and intergovernmental negotiations set in motion with the aim of establishing the European Atomic Energy Commission (Euroatom) and the European Economic Community (EEC). The Treaties of Rome establishing these two institutions were signed by the Six on March 25, 1957; together with the earlier ECSC Treaty they form the constitution of the European Communities.

The Common Market

The EEC Treaty sought the establishment of a common market, free of trade barriers, in which goods, services, labor, and capital would move without hindrance across national boundaries.

The economic rationale for such a market was firmly grounded on the principle that international trade among countries with different resource endowments is mutually beneficial to all of them, and that specialization based on comparative advantage leads to greater efficiency in resource allocation and thus raises the overall level of welfare. Further, a larger market may provide firms with the advantages of economies of scale in production, marketing, and research and development.

The initial step taken to create a common market involved two elements. One was the elimination of customs duties, equivalent taxes, and quota restrictions on intra-member state trade; the other was the establishment of uniform custom duties for goods entering any member state from third countries. To achieve these ends the EEC Treaty set a timetable for the gradual reduction of tariffs over a 12-year period, a process which was to culminate in the establishment of a common external tariff (CET) for imports from nonmember countries. This was achieved in mid-1968, 18 months ahead of schedule. When Denmark, Ireland, and the United Kingdom joined the Community in 1973 (and when Greece became a member in 1981) they were given five-year transition periods to dismantle tariff and non-tariff protection. Portugal and Spain, upon joining in 1986, were granted seven-year periods to adapt.

The gradual but widespread reduction of tariff protection (including lowering of the CET) contributed to an enormous expansion in the volume of both intra-EEC trade and trade vis-à-vis the rest of the world. Between 1958 and 1985 intra-EEC exports as a proportion of total exports for the ten members rose from 35 percent to 53 percent, while the ratio of intra-community exports to GDP rose from 4.9 percent to 14 percent. The EC countries are among the most open economies of the world as measured by the ratios of trade to GDP. Between 1958 and 1985, for instance, the ratio of imports of goods and services to GDP for the Ten rose from about 19 percent to 32.4 percent. The corresponding ratios in 1985 for the United States and

Japan were 10.2 percent and 11.7 percent, respectively. By 1985 the EC had become the largest trading bloc in the world accounting for approximately 20 percent of total imports and exports (excluding intracommunity trade).

Notwithstanding the rapid expansion of trade, there are a number of factors that have prevented the emergence of a fully developed internal market. These include differences in customs formalities and differences in health and safety requirements; such practices introduce price differences for the same good insofar as imports from third countries are concerned. The Treaty's original declaration that member states could, under certain circumstances, maintain quantitative restrictions on the grounds of "public morality, public policy, or public security," health, or the "protection of industrial or commercial property" has been sometimes used to erect protectionist barriers, thus obstructing the achievement of a free internal market.

An important step toward the creation of a unified internal market was taken in 1985 when the Heads of State of the member countries endorsed the recommendations put forward by the Commission for the completion of the internal market. A detailed legislative agenda was drafted-affecting trade in goods and services, labor and capital mobility, transport, and the harmonization of laws and regulations—and is to be implemented by 1992.

Labor mobility

The Treaties of Rome provide for the free mobility of the factors of production across national boundaries. Community workers should not be discriminated against on the basis of nationality and should enjoy equal rights and privileges in regard to employment, remuneration, and other working conditions. The free mobility of labor was implemented by the Community in a number of stages, between 1961 and 1968, by which time free labor mobility became a reality. The progressive relaxation of national controls was accompanied by complementary measures to remove other possible barriers to labor movement. Foremost among these was the right of a worker to

transfer social security rights to another member state. In time, migrant workers became eligible to receive the same social security benefits as national workers, and periods of employment and contributions made in two or more member states could be aggregated for the purpose of determining the appropriate level of benefits.

The distortions that could have come about as a result of the different levels of national taxation—with labor presumably moving to low-tax member countries—have not materialized. Language and other cultural differences may have thus far acted as the most important disincentive for a greater degree of labor mobility. At the same time the 1970s and 1980s have witnessed a steady deterioration of labor market conditions in virtually all of the member countries, with the average rate of unemployment in 1985 being about 9 percentage points higher than in 1970. Nevertheless the free mobility of labor is a reality within the boundaries of the EC (it is to be achieved by 1992 with respect to Spain and Portugal) and stands as one of the most significant accomplishments of the EC's first 30 years.

Services

The Treaties of Rome also called for the elimination of restrictions that might prevent self-employed individuals and firms from setting up facilities and providing services in other countries. The freedom to supply services across national boundaries appeared to be a natural adjunct to the freedom of movement for goods which the gradual dismantling of tariffs and quotas was intended to accomplish. Equal rights of access to work in other member states were guaranteed on a nondiscriminatory basis, that is on the same conditions as applied to nationals.

This general principle notwithstanding, certain obstacles emerged that prevented the full implementation of the measures called for in the Treaties. In the case of the professions, for instance—the health sciences perhaps being the best example—the existence of differing licensing requirements laid down by each member state, as well as

the right of members to enact certain types of protective legislation (for example, for purposes of consumer protection) led to substantial delays in the creation of mechanisms that might allow professionals to move freely between member states. There have also been obstacles to the provision of insurance across national boundaries. Thus an insurance company wishing to establish a branch in another member state could do so only if it satisfied all the conditions—as regards reserves, margins of solvency, etc., which were sometimes more stringent than those existing in the home country—demanded by the host government.

The progress made thus far on the freedom to supply services across national boundaries has been considerably slower than that achieved for the free movement of goods. The need to speed up the establishment of a common market in services is underscored by the increasing relative importance of the services sector within the Community, both in terms of value added and employment prospects. By the mid-1980s services in the Community accounted for over 55 percent of value added while the manufacturing sector's contribution had fallen to around 25 percent. The steady decline of employment in industry over the past decade likewise stands in sharp contrast to the healthy growth of employment in both the traditional services sector—banking, insurance, transport—and those associated with the development of new technologies, such as information and data processing, computerized marketing and distribution, and audiovisual services. The completion of the internal market by 1992 should help remove the present obstacles to the provision of services across national boundaries and thus contribute to a more efficient allocation of resources within the Community.

The European Monetary System

The gradual establishment of a common market strengthened the bonds of economic interdependence between the member states and began to impose certain limitations upon the pursuit of national economic policy objectives.

Economic policy measures implemented by each member state began to have a much greater impact upon its partners than at any other time in the past. This greater interdependence in time gave rise to the Community's first attempt at monetary integration, the Werner Plan of 1970 (named after Luxembourg's Prime Minister), an ambitious attempt to establish a monetary union by the end of the decade. Although a Community exchange rate system was established in April of 1972, the floating of the dollar in 1973 and the emergence of important divergences in economic policies among member states in the wake of the first oil crisis, led to the system's gradual shrinking into a *deutsche mark* zone.

The creation of the European Monetary System in March 1979 has proved to be a far more successful attempt at monetary cooperation. Participating currencies in the EMS exchange rate mechanism were to maintain 2 1/4 percent margins of fluctuation around bilateral central rates (the margin for the Italian lira was 6 percent) expressed in terms of the ECU (European Currency Unit), a basket of fixed amounts of the currencies of EC member countries. The ECU serves as the indicator to determine the magnitude of one currency's deviation from the others, and as the unit of account for all interventions and transactions under the credit facilities. It is also being increasingly used in private sector transactions. Originally conceived as a way of stabilizing exchange rate fluctuations and thus reducing uncertainty for traders and investors, the EMS has contributed to a significant reduction in the variability of nominal exchange rates and a convergence of prices and costs among member countries. The average rate of inflation in the EMS group of countries—all the 1979 members except the United Kingdom, whose currency is included in the ECU but not in the exchange rate mechanism—has fallen steadily from 11.3 percent in 1980 to 2.5 percent in 1986. Nominal wages and unit labor costs have likewise exhibited a marked degree of convergence.

The success of the EMS notwithstanding, the progress made thus far in the area of monetary cooperation falls

short of the Werner Plan's original objectives which, *inter alia*, proposed the creation of a Community central banking system with ample executive responsibilities in the area of Community monetary policy. The completion of the internal market is likely to test the strength of the EMS in coming years as remaining exchange controls are removed and the process of capital liberalization continues.

Agriculture

Agriculture is the most important sector in which the Community has sought to evolve a common policy, in accordance with the specific sectoral objectives set out in the Treaties of Rome. The objectives of the policy have included increased productivity, a "fair" income for the agricultural population, the stabilization of markets, the ensuring of adequate supplies, and the maintenance of reasonable prices for consumers. Given the scope for potential conflict between these various aims—the improvement of farm incomes versus the interests of consumers, or self-sufficiency versus the access of non-member countries to the EEC market also provided for in the Treaty—it is perhaps not surprising that the system which eventually emerged was a delicate compromise between opposing interests. These were, on the one hand, the national interests—as represented by the ministers at the Council—with economically important and politically powerful agricultural constituencies, and the European interest as seen by the Commission, on the other.

The main instrument of the EC's Common Agricultural Policy (CAP) has been an elaborate system of price supports which would simultaneously provide an adequate remuneration to farmers and insulate the market from undesirable price fluctuations. The intervention mechanism involves three types of prices: target prices, which are deemed to be consistent with the goal of supporting farmers' incomes; intervention prices at which official support-buying by the Community—in unlimited quantities—takes off the market excess supplies and thus provides farmers with a minimum

guaranteed income; and threshold prices which are applied to imports from non-member countries and thus provide a measure of protection. In addition to these, in the 1970s a system of border tariffs and subsidies was introduced to offset the effects of exchange rate changes on the level of support prices expressed in national currency terms. These adjustments at the border, known as monetary compensatory amounts, arose out of the disorderly conditions then prevailing in the exchange markets and, although they were expected to be of a temporary nature, remain firmly in place today.

The price support operations as well as those aimed at structural reforms are financed through the European Agricultural Guidance and Guarantee Fund. Because nearly two thirds of Community spending has been absorbed by the operations of the CAP—particularly the buying and storing of surplus produce at relatively high prices and occasional subsequent sale in world markets at lower prices—no other Community policy has been the subject of greater scrutiny and criticism. The widely held perception that the CAP's intervention mechanisms have given rise to distortions and inefficiencies in resource allocation has tended to dominate public discussion of the common market, and has frequently cast a shadow over many of the Community's other accomplishments. Indeed, in the minds of some critics the common market has become synonymous with the implementation of an agricultural policy which stimulates overproduction without any bearing on market realities.

The achievements of the CAP and its overall efficiency need to be examined against its original objectives and within the context of the EEC's common trade policies. To begin with, the CAP did lead to the stabilization of markets. The price intervention mechanism resulted in agricultural prices within the Community being more stable over time than other prices and more stable than prices in the world markets. Support buying and stock-adjustments have likewise compensated for supply and demand fluctuations. The CAP also contributed

to greater self-sufficiency; whereas in 1960 the Six were self-sufficient in only four out of ten key agricultural commodities, by the early 1980s the number had risen to nine. Agricultural productivity has likewise increased rapidly, leading to a widening gap between the rates of growth of production and consumption. The price intervention mechanism, however, has prevented necessary price adjustments and as a result surpluses have continued to rise. To the extent that CAP prices have tended to be above those prevailing in the world markets, the CAP's original goal of securing "reasonable" prices for consumers has not been met.

Other criticisms leveled against the CAP include: (1) that it is regressive in nature since, by artificially raising the price of food—to support farmers' incomes—it undermines the welfare of the poor among whom the share of expenditure on food is the highest; and (2) that the emphasis on self-sufficiency may have had an adverse impact on non-member country producers by restricting access to the market; hence the Treaty's requirement that Community policy should contribute to the harmonious development of world trade may have been violated. Furthermore, the monetary compensatory amounts continue to exist despite the fact that the EMS has re-established a large measure of exchange rate stability.

The open-ended nature of the CAP's price support system has in recent years put increasing strains on the Community budget and has led to widespread calls for reform. At the heart of these proposals is the notion that price policy must reflect prevailing market conditions.

Other common policies

There are a number of other areas in which the Community has attempted to establish common policies and where progress has been considerably more limited. The Treaties called for the creation of a transport policy on the grounds that the emergence of more efficient methods of transporting goods between states could have trade-creating effects similar to those associated with the process of tariff reduction. But unlike

agriculture, the Treaties left to the Commission the working out of the policy's objectives and the mechanics of implementation. Partly because the transport sector has been one of the most regulated within the Community, some of the Commission's original proposals—such as the need to create "competition of the widest scope" in the provision of transport services—did not receive the requisite level of political support.

A common energy policy was also thought to be an important Community objective. Differing national policies with regard to energy could give rise to distortions of competition or different approaches to the problem of dependence on imported sources of supply. Progress on this front has been limited for a number of reasons. Jurisdiction over energy matters has been divided, with the ECSC having responsibility over coal, Euroatom over nuclear power, and the EEC over oil, hydro-power, gas, and electricity. As in the case of transport the Treaties did not contain a timetable for the implementation of energy policy. National self-interest—particularly after the first oil shock—and heavy government intervention in the energy sector were further factors undermining the development of a viable common energy policy.

The completion of the internal market presupposes the implementation of a significant number of common policy measures affecting the agricultural, transport, and energy sectors. The internal market may thus act as the catalyst which will trigger further progress in the development of the EC's common policies.

Prospects

The Community's first 30 years may best be characterized as a series of achievements tempered by setbacks, and innovations in the wake of stagnation. The member states' commitment to integration and increased cooperation has coexisted with a reluctance, stemming from a desire to safeguard national interests, to transfer sovereignty to the Community institutions. The extent and the speed of progress has thus been

largely determined by the relative strength of these two forces. Overly ambitious initiatives—much like those that preceded the creation of the EEC—have been discouraged and ways have been found to keep the pace of change attuned to domestic political realities. The unanimity rule adopted in 1966, which effectively gave members veto power over Community decisions on the grounds that they might wish to defend "vital interests," is a good example of the latter force gaining the upper hand. In time it led to segmentation in the decision-making process, weakening the chances for consistency between different policies.

In spite of these setbacks, the 1980s have seen significant progress in a number of key areas. The EMS has succeeded in creating a zone of exchange rate stability through a greater coordination of financial policies and has led to the increasing recognition that such coordination will probably have to be brought under the control of a European central banking system. The Council's 1985 call on the Commission to "draw up a detailed programme with a specific timetable to achieve a single large market by 1992" is further evidence of a renewed commitment to the accomplishment of the Treaties' original objectives.

But perhaps the most recent significant development—and one that is likely

to have a profound influence upon the evolution of the Community in coming years—is the 1987 unanimous ratification by the member states of the Single European Act, an amendment of the Treaties of Rome. In addition to providing for the completion of the internal market, by restricting the rights of members to veto decisions in many key areas, particularly those pertaining to the elimination of barriers to the free flow of goods, services, labor, and capital, the Single European Act provides for a significant streamlining of the decision-making process. It is the legal instrument which will permit the speedy implementation of the legislative agenda set out for the completion of the internal market. The Act also brings under the jurisdiction of the Treaties new fields of concern—for example, the environment—and sets up a permanent Secretariat for political cooperation on foreign policy matters. Furthermore, it recognizes the competence of the Community in the area of monetary policy and enhances the consultative rights of the European Parliament.

Underlying these important policy and institutional developments is an increasing degree of popular support for the ideals which gave rise to the creation of the European Community. EUROPE 2000, a comprehensive opinion poll carried out by the Commission on the occasion of the thirtieth anniversary of the

Treaties of Rome to assess European citizens' attitudes about "Europe," showed, among other things, that two out of three EEC citizens are in favor of the Community developing into a "United States of Europe" within the next 20 years and that nearly 60 percent would entrust a European supranational authority with responsibility over economic policy, foreign affairs, and defense within the same period. This is an extraordinary statistic that indicates a marked shift not only in economic attitudes, but in psychological reflexes between generations which appear to be moving from an unquestioning faith in national sovereignty to a searching belief in more comprehensive loyalties. Against the background of several centuries of hostile nationalism and conflict, the results of this survey underscore the enormous changes that have taken place in the last four decades in the attitudes of the average European citizen, changes which augur well for the future of the Community.

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