Unity with diversity in the European economy: the Community's Southern frontier

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Preface

This volume contains the proceedings of the concluding conference of a research project on ‘Economic Integration in the Enlarged European Community’, conducted under the auspices of the Centre for Economic Policy Research. The conference was hosted by the European Cultural Center at Delphi on 26–27 October 1989. Our thanks are due to Pericles Nearhou for making available the facilities of the European Cultural Center, and to Litsa Florentis at the Center and Ann Shearlock at CEPR for their work in organizing the conference.

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15 January 1990

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Foreword

MICHAEL EMERSON and
RICHARD PORTES

Territorial enlargement versus deepening of the integration process: the European Community has been persistently concerned, if not at times tormented by this dialectic. It was true of the first enlargement in the 1970s. So also in the 1980s, as the Community decided more ambitiously than in the previous decade to enlarge and deepen both at the same time. Greece joined in 1981, and Portugal and Spain in 1986. Thus the second enlargement saw the Community's divergences in terms of level of development widen considerably. Notwithstanding, 1985 saw the Commission advocate a new push to complete the Single Market in the eight years to follow.

Already by 1988 the agenda lengthened further, with renewed consideration being given to monetary union. Spain then joined the European Monetary System in 1989. Also in the late 1980s the issue of further enlargement was being posed again, this time by Turkey in 1987 and Austria in 1989; and the broader question of EC–EFTA ties became prominent. At the close of the decade the Community's future relationship with Eastern Europe came explosively to the top of its priorities.

The present study has attempted to throw light on the economics of this dialectic between widening and deepening. The questions of concern to the politicians have been quite clear. Put in a neutral way, could the relatively weak economies of the new, geographically peripheral Member States withstand the double shock of accession and completion of the Single Market? Worse, might their economies be driven into relative depression, as was seen in the Mezzogiorno after Italian unification? Or better, might the double shock enable these countries to accelerate their modernization? Do economic principles point to a pre-determined outcome? If not, what are the conditions for securing the better outcome? What should be the responsibilities of national and Community authorities in this process?

At the outset of the research programme reported here, there was no self-evident answer to these questions. Economists were variously able to point both to divergence as well as convergence theorems. On the right, Adam Smith optimists presumed that the invisible hand would secure advantage for all. On the left, Kaldorian pessimists feared for the progressive immiserization of the weak and peripheral regions. The fundamental issue was quite open.

It is for the editors, Christopher Bliss and Jorge Braga de Macedo, to draw together the conclusions of the various studies in a comprehensive manner. For our part, we draw attention selectively to some of the main points that emerged at the programme's concluding conference in Delphi in October 1989.

One fundamental conclusion is that in fact no simple paradigm, be it that of the Adam Smith optimists or the Kaldorian pessimists, prevailed. It all depends. This may sound like banal agnosticism or the well-known story of the two-handed economist. But the conclusions are in fact a good deal more dramatic.

The degree of indeterminacy in the likely outcome is not a small margin surrounding a neutral centre point. Rather, several arguments point to a wide possible range of positive or negative impacts. Since these can accumulate, the range of overall possible outcomes may indeed be between brilliant achievement and big difficulties. Four examples of this type – the arguments that can go either way – may be picked out.

First comes an argument from the analysis of industrial organization and the location of investment, as set out by Paul Krugman and Anthony Venables. A small, peripheral and previously protected economy stands to make particularly large gains in economic welfare as a result of integrating with a large, efficient economy. The relatively low wage may also then attract investment from the core. On the other hand, there will be some tendency for industry to concentrate nearer to the core region, partly because of the higher amount of protection relinquished by the peripheral economy. It seems difficult to know *a priori* on which side the balance of advantages will fall.

Second is an argument well known in the literature about the sequencing and design of programmes of measures to remove market distortions. A first-best solution is usually seen as coming from a comprehensive improvement of product and factor markets. If instead only partial reforms are undertaken while other pronounced market distortions remain, then the size of the likely gains may be highly uncertain, and the partial reforms might even bring overall losses.

In the case of EC enlargement and completion of the internal market, the accent is on the liberalization of the markets for tradable goods and services and internationally mobile capital. Labour markets are little affected: external mobility is assured, but internal rigidities are not directly attacked. In addition, public goods and services and many aspects of financial market regulation are not directly affected. Thus the externally imposed reforms are indeed only partial. The country studies for Greece, Portugal and Spain analyse the extent to which these countries are so far succeeding or failing with their internal measures to assure overall coherence of their policies addressed to product and factor markets.

Third is a related argument which has a more institutional character. The issue is whether the Member States can secure support from the Community institutions in the pursuit of national policy objectives. Comments at the conference by Konstantine Gatsios used the example of competition policy, where the Commission has an independent capacity to rule national subsidies illegal. If national governments and the Commission pursue consistent objectives, for example to secure higher efficiency in enterprises earlier benefiting from state support, the Member State can derive enhanced credibility for its own policy. But if the Member State and the Commission are working at cross purposes, the confusion perceived by the private sector can be very costly for the economy.

Fourth is an argument relating to the structural funds, which is set out in the paper by Christopher Bliss. Widely differing impacts are possible. In the worst case the beneficiary, whether government or private sector interests, is induced to pursue rent-seeking strategies rather than advances in productivity to complement the funds' contribution to improving infrastructure or the stock of labour skills. In the best case the beneficiary pursues these complementarities, and more broadly the nation is encouraged to raise its level of ambition in responding to the challenges of integration into the EC and modernization.

The accumulation of these four arguments points out both opportunity and risk. If all four factors can be turned positively, their combination can become not just a set of policy improvements, but rather a comprehensive and credible regime change, so perceptions of the economic attractiveness and prospects of a country may be quite transformed. Synergies are created. In the contrary case, there may be a failure in the processes of competition, with severe costs and delays before the resources of non-viable enterprises are redeployed more efficiently. The three country studies portray Spain as coming closer to the former model, Greece closer to the latter, with Portugal occupying a somewhat ambiguous position in between.

These were major themes at the conference. There were also several issues that might have been expected to emerge strongly, but did not in fact do so. These instances of 'the dog that did not bark' may offer clues that will help in identifying the key determinants of success or failure in the integration process. Here we give five important examples.

First, participants did not call for massive expansion of the structural funds. As suggested above, it is quality that will be decisive, at the already planned substantial quantity. Efforts should focus on proper targeting and implementation of structural fund policies and complementary measures at national level.

Second, although at the onset of the research we had expected cross-border labour migration in the Community to be a prominent theme, in the event it played a relatively minor role in the studies and the conference. There was considerable discussion of the problems of national labour markets, but international mobility of labour between the South and North of the existing Community drew much less attention than the integration of goods and capital markets.

Third, although the Brussels compromise of February 1988 has surely not resolved the Community's problems with the Common Agricultural Policy – if only because of its effects outside the EC – the CAP went virtually unmentioned in the conference papers and discussions. It is clearly of major significance for the economic structures of the recent entrants, and for intra-EC resource transfers, but it may perhaps be taken in its current form as a datum in assessing how the integration process will work over the next several years.

Fourth, the often acrimonious disputes over 'harmonization' and Brussels-imposed uniformity in the approach to 1992 also did not feature in our meeting. These issues – the details of taxes, standards and regulations – are perhaps more significant to the more developed countries in the Community. They will have relatively little bearing on the success or failure of the integration process for Greece, Portugal and Spain.

Finally, we heard little of the arguments over fiscal rules and macroeconomic policy coordination that have become so important since the Delors Committee Report. Of course policy choices with regard to the EMS, particularly for Greece and Portugal, were major future themes, as was the progressive loss of monetary policy autonomy, but there was much more attention to the domestic constraints on and problems of fiscal policy than to any rules that might be prescribed centrally.

These are the lessons we drew from the conferences and the research programme it summarized. Their importance is much enhanced by current developments in Eastern Europe. The work presented here illuminates the key issues underlying the interplay between widening and deepening in the existing European Community. It suggests the relevant questions in examining possible forms of association with the Eastern countries, as well as others that have indicated their desire for closer attachment to the Community. The experience of Greece, Portugal and Spain may also help to interpret and guide the development policy choices of the Eastern countries.

Moreover, there is little doubt that beyond the widening-deepening dialectic there lies ahead for the Community a similar and fundamental tension between North–South and East–West integration. We may hope that the research reported in this volume will contribute to understanding and perhaps to resolving these tensions. We commend it to the reader.