Amy Skolnik
Bank of Finland Economics Department
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THE EC INTERNAL MARKET: AN "ECONOMIC UNITED STATES" OF EUROPE

Suomen Pankin monistuskeskus
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ABSTRACT

In 1985, the EC Commission set about creating an internal market which would allow for the free flow of goods, services, labor, and capital between all member states. Since then, concrete progress in opening markets and removing barriers has been made in the areas of financial services, procurement methods, transportation, and standards. However, there are a few fundamental obstacles that will prevent the EC from attaining its final goals. These include the issues of taxation, open borders, lack of a single monetary system, and above all, national interest. Member states greatly fear the loss of their independent policy-making power. In contrast to the U.S., with its vast single market, the EC nations have many cultures, languages, and customs; something that is not likely to change. It is these factors that will ultimately prevent full cooperation and complete integration within the European Community. This paper analyzes the main areas of progress as well as the major problems of the Internal Market and focuses on the proposal that the Internal Market will create an 'United Economic Unit' comparable to that of the United States.

TIIVISTELMÄ

Euroopan yhteisön komissio ryhtyi vuonna 1985 valmistelemaan sisämarkkinoita, jotka sallisivat tavaroiden, palvelusten, työvoiman ja pääoman vapaan liikkuvuuden kaikkien jäsenmaiden välillä. Tähän mennessä on konkreettista edistymistä tapahtunut markkinoiden avaamisessa ja esteiden raivaamisessa rahoituspalvelujen, hankintojen, kuljetusten ja standardien osalta. Lopullisten tavoitteiden saavuttamisen tiellä on kuitenkin muutamia perustavaa laatua olevia esteitä. Näihin kuuluvat verokysymykset, avoimet rajat, yhtenäisen rahajärjestelmän puuttuminen ja ennen kaikkea kansalliset edut. Jäsenmaat pelkäävät suuresti itsenäisen päätöksentekovaltansa menettämistä. Päinvastoin kuin Yhdysvalloissa, joka muodostaa laajan yhtenäisen markkina-alueen, EY-maissa on monta erilaista kulttuuria, kieltä ja tapaa, joiden suhteen voidaan tuskin odottaa muutoksia. Näiden tekijöiden olemassaolo tulee lopulta estämään täyden yhteistyön ja integraation Euroopan yhteisön piirissä.

Tässä selvityksessä tarkastellaan kehitystä tärkeimmillä alueilla ja pohditaan suunnitelman keskeisiä ongelmia, kiinnittäen huomiota erityisesti ajatukseen, että sisämarkkinoilla luodaan Yhdysvaltoihin verrattavissa oleva "yhtenäinen talousyksikkö".

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I. INTRODUCTION

The plan, by the Commission of the Economic Communities (EC), to create a single, internal market by 1992 is one of today's most discussed topics. International newspapers are full of commentaries and opinions; diplomats, politicians, and economists can be heard debating the issues; yet ironically, there are very few facts. The internal market plan was launched, in 1985, with grandiose intentions but virtually no background studies or research. It is only very recently that any analytical work on the effects of "1992" has been conducted and even it leaves many questions unanswered. What does this plan really mean? Is it merely European propaganda? Or does it have some concrete implications for EC nations as well as for the rest of the world? This paper will highlight the background, major progress, and current obstacles of the internal market project. It will also assess the likelihood of completion through analytical studies as well as a comparison to the United States market.

Laid out in the EC White Paper of 1985, the internal market plan calls for liberalization in the areas of goods, services, capital, and labor. Through the elimination of trade barriers, it plans to create one of the world's largest single markets, comprising about one-third of world GNP. It aims to increase Europe's international competitiveness vis a vis Japan and the U.S. All this will be accomplished through directives based on the principle of deregulation, an enhanced role for competition, and the concept of mutual recognition. Though the goal is to complete the internal market by 1992, it is unlikely that all of the 300 directives in the White Paper will be implemented by this date. However, the process is more important than the speed, and eventually it will be accomplished whether in 1993, 1994, or later. The Commission is already working on a 5 year plan to begin after 1992.

II. EUROPEAN NATIONS TAKE THE FIRST STEPS TOWARDS COOPERATION

The concept of a European common market is not new. The Treaty of Rome, which created the European Community in 1957, set about uniting Europe, beginning with the removal of quotas and tariffs. This led to a rapid increase in intra-Community trade and high growth levels for most member countries. However, through the 1960's and 1970's, protectionism gradually reappeared. The currency instability and oil shocks of this period, among other events, resulted in many nations imposing non-tariff barriers and most attempts at further integrating Europe failed. It was not until the early 1980's, when countries became accustomed to lower overall growth rates and adjusted to a higher natural rate of unemployment, that liberalization began to be discussed again in earnest.

The early 1980's also found Europe feeling the effects of a real decline in international competitiveness as Japan and the U.S. were growing at much higher rates. Between 1980 and 1986 GDP increased by 24 % in Japan, 20 % in the U.S., but only 10 % in the EC. In 1987, Japan and the U.S. had a GDP per capita of 16,869 ecus and 15,857 ecus respectively, where as the GDP per capita of the EC nations was only 10,260 ecus. European industrial output and market share were declining as well relative to the U.S. and Japan, and the EC was particularly lagging behind in research and development and in high-technology sectors.

In addition, high barriers to entry kept European businesses fragmented with price differentials of up to 20 % across borders. Venables and Smith claim that there is some home-market bias of sales by European firms as well as a tendency to price less aggressively in the domestic market. Though some of this may be attributed to a difference in national tastes and culture, it also adds to the decrease in competitiveness.

The EC governments began to realize that cooperation was needed if their economies were to expand and their industries regain efficiency and competitiveness. Many saw the potential to parallel the structure of the United States, with its fifty states yet one single market. The EC Commission, capitalizing on a positive economic and political atmosphere, prepared an elaborate set of 300 directives aimed at creating a completely unified internal market.

The pragmatic approach of the White Paper won over the most ardent nationalistic skeptics. Drawing upon past experience, its creators cleverly did not prioritize any of their objectives, an issue which always had divided member countries. In addition, rather than requiring member states to conform through harmonization to a set of Euronorms and Eurorules, the Commission approached the internal market through a process of mutual recognition; thereby acknowledging that there are many sensitive national issues. This led to the concept of eliminating the unseen barriers of within, as well as at frontiers.

III. RECENT PROGRESS AND DEVELOPMENTS HAVE BEEN FASTER THAN EXPECTED

After a somewhat slow start, the EC plan for a "Europe without frontiers" has recently gained momentum and international recognition. For many businesses, it has become a state of mind and can already been seen in their strategic planning. Many European governments have launched extensive campaigns to educate the public. This change in attitude and perception of both the people and member state governments is one of the biggest accomplishments of the White Paper. There is an air of cooperation and collaboration. Many have realized that alternative choices and sacrifices must be endured for future gains and competitiveness.

Since its release in 1985, many of the internal market directives have been accomplished. Tangible progress can most be seen in the following areas: financial services, technical barriers and standards, procurement methods, competition rules, and transportation. Though no area can be examined in isolation, each of these fields has been significantly liberated relative to past procedures.

A. The rapid liberalization of financial services can not occur alone

The financial sector, which accounts for 3 % of all EC workers and 6 % of all EC pay, has endured the most radical changes under the 1992 plan. It comes the closest to realizing the single market ideal. This is particularly due to the fact that liberalizing financial markets is currently a worldwide trend. In addition, frontier posts are irrelevant as most business is done via telephone wires or satellites.

One example of how the opening of borders for financial services will have significant affects is in the area of price differen-

tials. Between EC countries, service charges, commissions, fees, etc. can vary as much as 50 %, with currency exchange variances rising as high as 250 % After the liberalization, financial costs are anticipated to decrease by an average of 10 % in the EC. This amounts to a savings of 21 billion ECU.

While these changes will bring significant benefits to the consumer; the financial sector of countries with high prices, such as Spain, Italy and France, will have to adjust quickly for fear of loosing their market share. This may prove very difficult as individual financial liberalization plans throughout the member states have progressed at different levels. Though the sum of changes is overall positive, resulting in a net gain through a higher level of efficiency and increased competition; it is necessary to try to ensure a smooth transition for those countries whose markets are currently very restricted.

There are three key segments to the EC's plan for deregulation of the financial industry: 1) the right to sell financial services across borders, 2) the right of financial firms to set up business across borders, and 3) the complete freedom of capital movement. The most recent achievement, towards these objectives, was the decision in June 1988, by the EC Finance Ministers to abolish all remaining capital controls by mid-1990. (With an exception for the poorest countries which have until 1992.) However, nothing stands in isolation. Nations in a free trade area with fixed exchange rates and full capital mobility can not pursue independent macro policies. Therefore, this last measure will require closer policy coordination among the member states, a step many will probably resist.

Though in theory the financial sector will be completely open, banking, especially consumer banking, remains difficult to enter and probably will stay nationally centered. It is much easier to sell goods across a border than a service. Individuals are willing to try a new product but the risks associated with an unknown financial institution or different service methods are

greater than most will take. In addition, banks are still meeting resistance when attempting to buy across frontiers. This can be seen in the recent treatment by the Belgians of Carlo de Benedetti as they fought off his takeover attempt for Société Générale de Belgique. In sum, though substantial progress has been made in liberating financial services, it can not occur alone. For these goals to be reached, other areas of the internal market plan must progress in tandem.

B. Existing technical barriers will be difficult to eliminate, but there is hope for new developments

Rated the single most important trade barrier by industrialists, technical regulations are an extremely difficult area to liberalize. In the past, every nation has had its own regulations and standards and it is estimated that there are over 100,000 different ones within the EC alone. For the Commission, these barriers of within will be attacked in three general ways: 1) by unifying and harmonizing standards, especially for new products and techniques 2) through mutual recognition of past regulations thereby allowing competitive standards to exist side by side and 3) by encouraging the development of European standardization bodies. The second manner is particularly challenging; for though a standard may be legally acceptable, many nations may not have the facilities to welcome it or a culture that will adapt to it. In addition, Euro-standards tend to be a result of the lowest common denominator and in many cases governments impose their own higher regulations due to consumer interests, health, or safety reasons.

However, in the past few years, progress can be seen in this area, particularly in the changed attitude and approach of business and government. The old concept of protectionism through standards has faded and a feeling of cooperation and consensus building has emerged. There is a growing enthusiasm among European industry for endorsing standards in advance, so that as

technology progresses, the problem of standards may begin to diminish. This can already be seen in the extensive EC discussions on high definition television (HDTV), mobile phones, and computer standards.

C. Transportation costs will be reduced

Both road and air transport should become cheaper after 1992, though the deregulation process has only just begun. Progress is most promising for truck haulage which is currently subject to a complicated system of permits and strong protectionism. The goal is to create a European market where there is no limit to the number of trucks crossing borders or the routes they take. The number of EC-wide permits is increasing by 40% annually, and the Commission hopes to be able to eliminate permit system altogether after 1992. The EC estimates that road-haulage prices will decrease by at least 5 % after deregulation. The changed attitude of the West German and Dutch trucking unions has helped to increase momentum. They account for one-third of all cross-border trucking in the EC, and were originally firmly opposed to the removal of the bilateral permit system. They felt that working conditions and tax rates should be harmonized in advance, but are now prepared to let the entire system evolve together.

D. Procurement plans will increase competition

The purchases of goods and services by government and public utilities accounts for 15 % of the EC's annual GDP or 530 billion ECU in 1986. Though required since the 1970's, to place large construction contracts and purchase orders out for Europe-wide tender, only about 2 % annually, go to a non-home country. The aim of the Commission is to increase the general transparency of public procurement by closing off current loopholes; increasing the provisions for complaints and for policing; and extending open procurement to the areas of energy, transport, and telecommunications, sectors that have previously been exempt.

There has always been a national bias in the area of procurement, which has led to inefficient and fragmented industries in Europe. This has also contributed to the varying European standards, though often "different standards" is the excuse to keep business at home. The inefficiencies become even more apparent when contrasted to the U.S., as each European nation has established its own monopolies. For example the EC countries have ten manufactures of turbo-generators while the U.S. has two; there are eleven EC makers of telephone exchanges but only four in the U.S.; and you will find sixteen locomotive manufactures in the EC compared with two U.S. ones.

If fully implemented, the procurement aspects of the internal market plan will lead to increased competition which will force domestic suppliers to align their prices with more competitive foreign ones. In the above stated industries, the number of producers should also fall, through mergers and reorganizations, thereby raising efficiency and utilization rates. This will also allow for closer coordination of research and development.

Telecommunications has traditionally been a closed industry, with every country maintaining its own monopoly over equipment, standards, and services. Recently, some advancements can be seen, particularly since the Commission published the Green Paper on Telecommunications in 1987. An increased awareness of standards, cost competition, and public outcry has forced governments to gradually begin changing their ways. Even West Germany's Bundespost, one of the most conservative PTT's in Europe, has recently placed an order for equipment with a British firm. This is certainly an encouraging sign.

IV. HOWEVER, THERE ARE SEVERAL POTENTIAL PROBLEMS AND OBSTACLES FOR THE INTERNAL MARKET PLAN

As we approach 1992, the number of simple, less threatening directives gets smaller (as they are accomplished), and the Commission is left with the most difficult and dividing issues. These include the problems of hidden government subsidies and other non-competitive measures; lack of a single monetary unit; and general language and cultural barriers. The political battle between the liberals and the interventionists continues to intensify with time.

A. National interest makes some directives difficult to accept

So far most directives have been of a deregulatory nature, which has been acceptable to all member states. However, much that remains, is strongly opposed by some members, particularly Britain. Four years ago, Mrs. Thatcher all but vetoed a draft directive on worker consultation. Recently, a revised version was approved by the EC Ministers along with a directive on social security and improved working conditions, but not without her hesitations. This faction does not believe that the EC should interfere with domestic or social issues and only supports the creation of an European 'Economic' Community.

France on the other hand, follows a dirigiste approach, often re-placing national regulations with community ones. (Though it has used project 1992 to begin liberalizing its own economy.) The faction behind France believes the internal market plan needs a "social dimension" to represent workers conditions and benefits, trade unions, and small entrepreneurs. Their rationale behind this is a fear that otherwise the internal market will become a businessman's Community rather than a citizen's. In addition to

the political battles, there are also more subtle problems left to be tackled such as the fear of a resurgence of "national interest", particularly in government procurement methods, as well as the enormous side effects from completely opening up national frontiers.

B. Completely open borders are unlikely

One of the main obstacles to the successful completion of the internal market by 1992 is the numerous problems caused by the opening of physical borders. The Commission is adamant that control posts must be completely removed. Goods, labor, and capital, must be able to flow freely for a truly open, single market to occur. Otherwise, even minimum controls, for valid reasons, will eventually reimpose barriers and/or restrictions. Currently, the basic cost of customs, testing requirements, delays, and general bureaucratic procedures resulting from border controls is estimated at 1 - 3 % of the value of trade. In addition, these barriers do not even generate any revenue.

The problem is, that the internal market is based on the economic principle of free trade. However, border posts regulate many other issues such as taxation, gun control, drug policies, immigration laws, technical and health standards, and even a nation's third party trade policy. In order to have truly open borders the EC members need to agree on a uniform policy for all these issues. No wonder very little progress has been made in this area.

When contrasted with the United States, it becomes apparent that this is a crucial area that must be resolved if the internal market is to come to existence. Much to the surprise of many, the U.S. has a number of state barriers such as strict trucking regulations, state controlled insurance companies, and highly regulated interstate banking practices. However, its lack of border posts and customs controls is key to a single market frame of mind which allows Americans to transcend these barriers. The

Interstate Commerce clause of the U.S. Constitution has been liberally interpreted over the decades to allow the free flow of virtually anything conceivable across state lines. Americans take this phenomenon for granted, but in Europe when national quirks, safety and health regulations, and varying standards all inhibit trade, the U.S. system is envied.

C. Taxation is a well guarded and highly prized domestic issue

The problems of taxation, which would arise from open borders, is one example where European feelings of national sovereignty shine bright. Customs controls allow each nation to set indirect taxes and collect their VAT. The standard VAT rates of the EC states vary from 12 % in Luxembourg to 25 % in Ireland. Open borders would end governments' ability to indiscriminately set rates as residents and businesses in high rate countries would flock to neighboring nations with lower rates for purchases. Denmark for example could loose up to 6 % per annum of its GDP, in the short run, if rates were harmonized to that of the average EC member. Taxation has always been a completely domestic issue and EC governments are reluctant to loose the revenue or their control. In Ireland and Denmark indirect taxes comprised 17.4 % and 16.8 % of GDP respectively in 1985. Not willing to suffer the revenue losses, both these countries have already illegally restricted the 350 ecu, EC duty-free allowance, to "genuine" travellers. Fearful of further restrictions, the EC Commission has taken a different approach than that of the U.S. where market forces keep indirect rates in line. (Sales tax ranges from 0 - 9 % in the U.S. with the gap between neighboring states less than 5 %.)

The Commission has proposed a compromise tax band with two rates. The standard range would be between 14 - 20 % and the reduced rates between 4 - 9 %. A clearing house system would be established to replace customs posts. So far there has been little support among member states. Some member argue for a policy of mutual recognition as in the U.S. where states have been able to preserve some

authority and respond to local demand. Competition has not led to a uniform rate and differentials have survived.

A study presented at the DRI International Economic Forecast Conference in October 1987, analyzed the affects and implications of the EC Commission VAT Harmonization Plan. In the long run, it concluded the plan benefits all: Border administration costs are eliminated and therefore producer costs also decrease. Competition increases which leads to higher efficiency as well as lower consumer costs. The average tax paid by EC individuals would also decrease. The potential indirect effects of harmonization, such as spillover effects and consumer substitution also can not be overlooked and it is important to study this plan within the context of the internal market.

However, the study noted that during the adjustment period, many individual consumers and businesses will suffer and some countries loose. Whereas the U.S. Government uses state and regional redistribution policies to ease the burdens, the EC has very few institutions or programs to help with the transition and after effects. Though they have set up some funds, for example in the agricultural sector, the system is new and the infrastructure undeveloped. Though there is some margin of maneuver, it will be difficult for some countries, such as Denmark and Ireland, to neutralize the effects of a decrease in government revenue. The largest sacrifice for many countries is their loss of an important policy tool.

V. UNITED MONETARY SYSTEM - A CRUCIAL MISSING LINK FOR THE COMPLETION OF THE INTERNAL MARKET

Another serious obstacle of the single market, is the lack of a uniform monetary unit or system. This issue has recently received much attention as the EC's leaders discuss increasing policy coordination as well as debate the pros and cons of creating a European central bank. At present, transaction costs and exchange-rate uncertainty still divide national borders, making inter-EC trade more expensive than domestic. A survey by the Bureau Européen des Unions de Consommateur found that it cost an average of 9 % and 5 days to move 100 ecus across an EC frontier. To fully enjoy the benefits of the internal market, businesses must be able to easily buy, sell and invest throughout Europe.

Many see a united European monetary system as a crucial link to the completion of the internal market. The micro and macro-economic gains of a single currency could be very high. (Imagine if all 50 U.S. states had a different currency.) Border delays would decrease, and efficiency would rise due to larger markets and stronger competition. On a macro level, monetary policy would be removed from national politics, which some believe would enhance financial stability.

This of course, assumes that a non-political central bank, dedicated to price and currency stability, is created to control the new monetary unit. Though support for this idea can be seen in France and by recent statements from the Bundesbank President Karl Poehl; many member governments feel it is an unrealistic plan and fear that an independent monetary authority would usurp too much power. The Dutch Central Bank President recently commented that exchange rates and monetary policy are too important to be left under the sole control of central bankers.

The creation of a single monetary unit would also raise many new problems. At present, the EMS (European Monetary System) allows for national devaluations to restore a currency's competitiveness. With one currency, governments would not only loose independent monetary policy power, but nations would have to result to adjustments through market cuts in wages and labor migration. Unfortunately, neither of these are completely flexible among the European states and there would be some difficult periods. Problems may be exacerbated as each country has a different idea of what is an acceptable unemployment rate. Also, whereas the U.S. has the advantage of a central authority, which helps regulate these problems through redistribution and aid, the EC is greatly lacking in this area.

Establishing a central bank is necessary if a Eurocurrency is created, but a central monetary authority could be extremely useful for other reasons as well. As mentioned earlier, to maintain stable exchange rates with free capital movements, countries must have converging monetary and fiscal policies. Though the EMS has partially been doing this, it is only because the other countries are willing to subjugate themselves to an essentially deutschemark standard. The system works because the Bundesbank follows a strict, conservative policy of preserving the currency value. What will happen if in the future another country's currency with less astute leaders becomes the leader? A non-political central bank may be the best way to keep monetary policy in line.

The study done by Padoa-Schioppa addressed this issue at length. It asserts that monetary stability and policy cooperation should be among the highest priorities of the EC Commission. The EMS, though it brings some convergence and stability, is a fragile institution and is unlikely to survive, especially once capital markets are fully opened in 1990. This study does not however recommend a single monetary union, for there are too many unreconcilable difficulties such as national attitudes, policies, and budgets. It believes the risks are too high. Instead, it

advocates an extension of the current EMS which would include: strengthening the actual mechanisms, joint management for policy coordination, a new model for safeguards, and more effective EC influence and control. The links between the private and official uses of the EMU (european monetary unit) should also be further developed. The study suggests that the EMS should begin playing an active role in the international monetary scene.

The largest obstacle to the creation of a central bank is of course, as with so many EC objectives, political. Governments are extremely reluctant to relinquish their monetary authority and policy controls. British Prime Minister Thatcher, the strongest opponent to an European Central Bank, has been extremely vocal on this issue indicating that Britain will never surrender its economic decision making power to another country. It is doubtful that any nation, in the near future, is going to allow its key assets to be controlled by foreigners. Already, this can be seen in the many recent takeover battles in private industry.

VI. ARE THE STUDIES ON EC INTEGRATION TOO OPTIMISTIC?

A. It is difficult to evaluate the effects of integration

The majority of studies done on the internal market plan have been optimistic and indicate that positive net gains will result from project 1992. One of the best known, the Cecchini Report, was commissioned by the EC. It is the most optimistic, though many feel it is overconfident. It estimates the savings for member states, from the creation of a single market, will be between 170 - 250 billion ECU. Approximately 5 million jobs will be created within 5 - 6 years and consumer prices are expected to decrease somewhere from 4.5 to 6.1 %. The direct effects of integration on EC GDP will be about a 2 % growth in the short run. In the long run, when economies of scale and competition results are included, growth is estimated at somewhere from 4.5 to 7 %.

The Cecchini study analyzes both the microeconomic and macroeconomic effects of European integration. This is a difficult task, as it is next to impossible to predict the dynamic effects one event will have on the next. In addition, though we speak of the EC as one unit, it is really still 12 separate countries with different structures, needs, and goals.

The microeconomic study examined how supply and demand, costs, and prices will be affected by the removal of trade barriers. Gains were broken down into four stages. The first two are the short-run effects of barrier removals affecting a) only trade and b) all production. The last two stages record the gains from market integration over the long-run through c) economies of scale from restructuring and d) increased competition which reduces inefficiency. The total gain, allowing for variations and alternative information sources, was estimated at a savings of 4.5 % - 6.4 % of GDP, or between 173 to 257 billion ECU. (Adjusted to reflect 1988 prices.)

The macroeconomic assessment of the internal market, analyzing the secondary affects of integration, focused on four main areas. The first is the elimination of frontier controls, which is felt will have significant psychological and strategic implications. More than any other event, this will be a signal of the irreversibility of the internal market process and a major factor in its credibility. The report found this attitude reflected in the overall perceptions of the single market process by private business. Though in the short run the opening of borders will cause unemployment in some countries, the benefits from increased trade (estimated at .4 % of GDP) and lower prices (estimated at -1.0 %) are larger and more permanent.

The other areas discussed were the opening up of public procurement, the liberalizing of the financial services, and the supply-side effects of a new competitive environment. Combined with the opening of borders, these factors, according to the authors' analysis, would reduce consumer prices by an average of 6.1 % and create approximately 1.8 million jobs.

Overall, the report stresses the need to examine short-term, long-term, and indirect effects as well as static vs. dynamic gains. Accordingly, it claims the benefits from integration will be seen in three main areas: 1) Welfare gains, through an increased range of products and services. 2) Improved technical efficiency through economies of scale in the short-run and fundamental restructuring in the long-run. 3) A decrease in costs and prices due to greater competition, as prices more closely reflect marginal costs. Though it is widely agreed that improvements in these three areas will occur, the amount is often questioned.

Some concern was raised in the report as to adequate enforcement of competition rules, the prevention of hidden government subsidies, and the provision of aid during the adjustment period. However, very little was said on these issues and there was virtually no criticism of the current Commission plans or overall

process. The authors did acknowledge that many economic and political conditions would have to be met, for these results to occur.

B. The EC Commission should set some priorites

The Padoa-Schioppa Study focused clearly on the areas in which it felt the Commission needed some improvements. In conjunction with its primary monetary and stability goals; it believes it is necessary to have an equitable system of redistribution to correct regional imbalances and aid structurally weak countries. In addition, this fund could help ease the transition for old industrial areas in economic decline as well as offer incentives to build up and restore high levels of physical and human capital. The study also stresses the need to monitor actual growth performances. The internal market must bring an increase in the rate of macroeconomic expansion, not just a reshuffling.

The study feels the Commission should be more selective and establish priorities focusing on monetary issues, regional policies, and increasing competition among rules. This last issue, the extension of the mutual recognition principle, is felt to be very important as it would minimize compliance problems that arise from forced harmonization.

C. Trade theory vs. EC reality

Krugman's studies include some of the most analytical work done on the European integration process. Through a theoretical approach as to why countries trade, he analyzes the benefits of a creating a single market. Gains from trade, he explains, result from 1) comparative advantage, 2) economies of scale, and 3) increased competition. The EC is looking to benefit from all three areas.

The benefits of specialization, which lead to a comparative advantage, are one of the oldest reasons to trade. However, over

the years they have decreased in significance, and in reference to the internal market, will only occur in a few sectors. Much of modern day trade consists of exchange of similar products between similar countries, i.e. intra-industry trade. This is especially true in the manufacturing sector of the EC. The one area were comparative advantage could have a significant effect is in research and development. The high costs of R&D, as well as the issue of national security, have either hindered large scale projects or required massive government subsidies. 1992 will make it easier for countries to collaborate on R&D and as well as share results. In addition, it will hopefully aid in unifying standards.

A second benefit of trade is the occurrence of economies of scale. The theory of increasing returns to production and decreasing transportation costs drives much of today's trade mechanisms. Yet, due to national differences, flooded consumer markets, and strategically important industries; it is unclear whether further benefits from economies of scale will be possible from the internal market. Much of this has already been accomplished through intra-industry trade. However, despite the uncertainty, the Commission is expecting economies of scale to play a large role in strengthening the integration process.

The last gain from integration that Krugman discusses is that of increased competition. Once markets are opened, companies should become increasingly worried about an influx of foreign competition. This will force them to become more efficient, reducing costs and prices. Competition will also help to reduce oligopolistic pricing as well as monopolistic tendencies, especially in large state-run firms.

Krugman also notes the adjustment and income distribution problems that arise from integration. When specialization does occur, it often brings disruptions as jobs are lost and factories changed. Though this is a temporary phenomenon, it can be quite difficult especially for the Southern countries with weaker infrastructures.

In addition, investment may migrate South, where labor costs are less.

D. It is necessary to examine the whole picture

In attempting to evaluate the internal market plan, it is essential to look at all the factors, for it is not a purely economic exercise. One must also consider the politics, culture, goals, and infrastructure of the countries, a fact many forget. Most analyses has been done under 'perfect' conditions, but this is not the reality of the world we live in. In addition, it is important to keep in mind that liberalization is currently a world-wide trend and the effects of the internal market project should not be overestimated.

The Cecchini Report does a good job of synthesizing the direct microeconomic effects with the overall macroeconomic picture, which is essential to effective policy making. However, its optimism is overstated. For example, in reference to its glowing assessment of the benefits of open borders, it neglected to look at the likelihood of completely opening frontiers. As mentioned earlier, there are still many obstacles to overcome before this will occur.

Though often vague due to the difficulty of accurate empirical work, the analyses of the internal market are extremely useful for the questions they raise and the issues they discuss. As Krugman states, it is beyond the scope of his paper to make detailed recommendations on policy issues or on concrete quantitative outcomes. Yet by raising the concerns and possible implications and results, the analyses add to the overall process of creating an internal market.

VII. CONCLUSION: 1992 - HOW REALISTIC IS IT?

EC Governments say they want a truly common market, but for that they must accept some common policies as well. Resistance to this can be seen in the recent backlash towards Mr. Delors', president of the EC Commission, comment that in ten years, 80 % of the economic, and perhaps tax and social legislation will be directed from the Community. If the internal market plan continues as expected, this premonition is not unlikely. However, national governments fear loosing their control and decision-making ability to an autocratic Community. "Common policy" can not be handed down but must form through democratic means. This is an area where the Commission need to improve. For the diplomats in Brussels, speaking of a single market or coordinated legislation is the norm. However, they must approach these subjects gradually in their home countries where these ideas are still quite foreign and the people still resistent to change.

The potential loss of independent policy making power, whether monetary as through a central bank or fiscal through a harmonized VAT system, is the fundamental obstacle to full European integration. Due to historical, cultural, and language differences, it is unlikely however practical and economically beneficial it is, that a single market with completely open borders will exist in the near future.

Though often compared to the U.S., plans for a "united states" of Europe fall short in three essential areas. The U.S. has one lan-guage, one currency, and one powerful central government that regulates the infrastructure. Other goals, taken from the American experience such as freedom of movement, lack of technical barriers, and absence of custom controls can be accomplished through EC legislation. Yet language and cultural barriers can not be harmonized away. Despite integration attempts, media will remain

largely in the home language. National identity is a tough barrier to break and even if labor mobility is legal, in contrast to the U.S., it is quite infrequent especially among professionals. With the exception of Luxembourg, no more that 6 % of the population of any EC state is non-native. In addition, national tastes, which influence products, marketing, and advertising, are not going to significantly change in many regions. The U.S. has a more flexible market and is more likely to adapt to new products and ideas, being in general, a more volatile society.

However, that is not to say that the 1992 internal market plan is a failure. It has been one of the most far reaching and practical plans towards a goal that initiated over 30 years ago. In economic matters, project 1992 has done much to rejuvenate Europe. Practically, it will increase competition, efficiency, innovation, and cut costs; even though to what degree is still uncertain. There is a definite potential for the EC to become a viable rival for the U.S. and Japan. Emotionally, the push towards 1992 has rekindled Europeans faith and self-esteem. The big question left is whether this pride develops in the form of increased nationalism or supranationalism.

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