# ECONOMIC PAPERS

COMMISSION OF THE EUROPEAN COMMUNITIES • DIRECTORATE-GENERAL FOR ECONOMIC AND FINANCIAL AFFAIRS

No. 76 May 1989

Europe's Prospects for the 1990s

by Herbert Giersch *

Internal paper

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# Europe's Prospects for the 1990s

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Internal paper

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II/186/89-EN This paper only exists in English

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## I. The Paper's Message and Outline

1. This paper suggests that Europe (EC 12) is ready for a re-acceleration of economic growth. GNP growth in the course of the 1990s may well approximate the rates achieved in the 1960s. The main arguments supporting this proposition will be elaborated in the main part of the paper. We start with a diagnosis and conclude with a description of the policy measures which are thought to be necessary for achieving the optimistic growth target.

## II. Diagnosis

2. Europe's long upswing - from the late 1940s to the early 1970s - was conditioned by three factors:

(i) the ambitions and motivations of a postwar generation;

(ii) a process of catching up
- with the past (reconstruction) and
- with the best-practice technologies in the leading country (the U.S.); and

(iii) a process of economic integration
- which started with the Marshall Plan and intra-European trade liberalisation under the auspices of the Organisation for European Economic Co-operation (OEEC) and
- which culminated in the completion of the EEC customs union ahead of schedule in 1968.

3. Europe's long upswing came to an end

(i) when a new generation brought about a change in the economic climate subsequent to the 1968 student revolt - with a shift of emphasis from output growth to income redistribution;

(ii) when markets slowed down at the end of the catching-up process while governments raised taxes, and while labour market organisations pushed wages and related labour costs to move faster than warranted by the trend growth of output per manhour;

(iii) when the gains from market integration were exhausted and Europe's terms of trade deteriorated under the impact of the oil price explosion in the world-wide boom of 1973.

Our interpretation of history takes these changes as endogenous consequences of prior developments, not as exogenous shocks.

4. The diagnosis of slower growth in the 1970s and early 1980s must focus on the following points:

(i) Profit margins declined under the pressure of rising costs of labour, energy and pollution control.

(ii) The real rate of interest was depressed,
- partly under the impact of the world-wide redistribution of incomes in favour of oil-rich countries and a hurried recycling of petrodollars,
- partly as a result of monetary acceleration and unanticipated inflation (exploitation of money illusion).

(iii) Capital was wasted in housing construction as a means of obtaining inflation-proof assets.

(iv) An excessive capital deepening took place: instead of creating enough new jobs for new entrants to the labour force, firms in Europe concentrated on making existing jobs more productive, quite in accordance with the distortion of relative factor prices.

(v) Wage-induced shedding of the least productive workers gave a boost to average labour productivity - as it is measured - thus masking the true extent of the productivity slowdown.

(vi) Under the impact of cost pressures technological progress was biassed towards process innovations - at the expense of product innovations.

(vii) In the category of process innovation, technical progress was biassed towards labour saving at the expense of capital saving innovations, again in line with the distortion of relative factor prices.

(viii) Instead of market liberalisation, a new wave of protectionism emerged in the international field (NTBs) as well as in the sheltered domestic sectors in Europe (overregulation) including the labour market (job protection) . European corporatism flourished at the expense of outsiders, i.e. of foreigners or of long-term unemployed at home.

(ix) "Eurosclerosis" became the label to diagnose Europe's economic inflexibility in the trap of slow growth and high unemployment.

(x) Governments, the welfare state and macroeconomic policies became discredited. They were widely perceived to have been oversold, overexpanded or misapplied. Deficits, debts and taxes became as bad words in the late 1970s as profits, prices and business had been a decade before.

5. In the course of the 1980s, some of the defects were remedied:

(i) The prevailing economic policy perspective shifted away from Keynes towards Schumpeter and Hayek. Enterpreneurs and innovators gained social prestige.

(ii) In search of the regenerative forces, participants in the policy debate shifted focus from demand to supply, including the supply of entrepreneurship.

(iii) The EC Commission propagated their co-operative growth strategy for more employment, calling for wage moderation, with support from the social partners.

(iv) Flexibility - of markets and within firms - was increasingly seen as an important condition for economic performance.

(v) The share of government in total domestic expenditure was lowered in many countries to make room for more private investment.

(vi) Budget deficits were reduced as a percentage of GNP (partly as a reaction to the high real rates of interest that prevailed when the inflationary overhang from the 1970s was attacked by the disinflationary policies of the early 1980s).

(vii) Tax reforms - either to shift the weight to consumption taxes or to broaden the income tax base for lower rates - were carried out to strengthen the supply of savings and capital or of skill and entrepreneurship.

(viii) The wave of deregulation, initiated by Carter in the 1970s, gave rise to imitating efforts in Europe.

(ix) Greece, Portugal and Spain were admitted to the E.C. - an undertaking which is (partly) equivalent to the liberalisation efforts in the 1950s and 1960s in the sense that it gave rise to more (healthy) import competition from countries in Europe which were ready to start a process of catching up.

(x) The European court established the principle of the country of origin while EC members agreed to mutually recognise their technical standards and norms.

(xi) The 1985 EC White Book on the Internal Market paved the way for a liberal (market oriented) interpretation of Europe's integration goals. The Single European Act made the programme stick.

(xii) The E.M.S. proved a success in the fight against inflation under the implicit leadership of the Bundesbank.

(xiii) Inflation rates declined in the whole OECD area, and Europe's terms of trade improved thanks to the decline in oil prices and the low prices of raw materials.

(xiv) Wage moderation in Europe helped to raise profit expectations - and expected returns from physical investment in Europe - over and above the real rate of interest that could be earned on financial assets (and hence elsewhere in the world). Europe thus became more competitive for internationally mobile resources despite the international crowding-out effect of the U.S. budget deficit.

(xv) The world economic environment improved - with reforms in China, Glasnost and Perestroika in the Soviet Union, the success of small (and hence more open) countries in the Far East, the employment miracle in the U.S., the free trade agreement in North America, the skillful handling of the international debt crisis.

(xvi) The stock market crash of October 19, 1987, proved to be a confidence test: instead of a recession it generated an unexpected prosperity thanks to the monetary policies pursued in response to the fear of an emerging liquidity trap.

(xvii) 1988 thus became the year with the highest GNP growth rate in the 1980s (4 % in the world's industrial countries) and a world trade growth even much faster (9 % in volume terms).

(xviii) High capacity utilisation rates give strong investment impulses; and high real interest rates ensure that the investment will be capital widening rather than capital deepening and will create more productive jobs than it was the case in the 1970s when the relation between wages and interest rates produced a labour saving bias.

(xix) Europe in 1989 is likely to produce almost as much real growth as in 1988, thanks to the capital widening component in the flow of investments and thanks to the flexibility efforts that will be undertaken in areas where capacity constraints are strongly felt.

(xx) These efforts can be expected in the labour market as well as in the supply of goods and services when firms and workers, perhaps even labour unions and regulating governments on the provincial and local level, will become increasingly aware of the wider and more intense competition they have to reckon with after 1992. Europessimism and Eurosclerosis tend to be overcome by Eurooptimism.

(xxi) With given profit expectations, firms in Europe do not seem to be overindebted; and world financial markets have not yet overvalued Europe's equity capital.

(xxii) The present merger movement can be taken to indicate a productivity potential from synergy effects and from unexploited computer facilities. It is said with plausibility that the computer can be seen everywhere but hitherto not in the productivity statistics. As this is likely to be true, the computer's full productivity potential will be revealed in the foreseeable future in the more integrated internal market.

## III. The Potential Growth of Potential Output in E.C. Europe

6. The maximum scope for faster growth in the 1990s can be judged by considering

(i) the past trend rate of output growth per person employed (labour productivity);

(ii) an increase of this trend rate in the future made possible by
- changes in the number of hours worked,
- a faster rise in the capital intensity or a faster rise in capital productivity,
- an accelerated improvement in qualifications (human capital intensity) or a better use of qualifications (human capital productivity),
- a faster intersectoral shift of resources from declining activities to high productivity activities;

(iii) an increase in the number of persons employed
- from the pool of the unemployed,
- from the number of persons in the working age group,
- from a rise in participation rates,
- from immigration.

7. In the EC (12), the trend rate of output growth per person employed (productivity) has been around two per cent for the last fifteen years, less than half as high as in the period 1960 to 1973, when it was 4.5 per cent. In this respect, Europe holds a middle position between Japan and the U.S. (European Economy No. 38, Table 20) which equally experienced a productivity slowdown after 1973. This slowdown is still largely a mystery unless

it is seen as a consequence rather than a cause of the slowdown in output growth. As a consequence, the trend rate of productivity advance is likely to rise once the overall conditions for growth have markedly improved.

8. The theory behind this view is implicit in the diagnosis presented at the beginning of this paper and can be summarised as follows: A combination of favourable conditions leads to a virtuous circle in the sense that markets outpace rigid organisations and governments and, by doing so, make the system more flexible and efficient. More people are forward-looking and adventurous; they embark upon offensive product innovations rather than defensive process innovations; they exploit the advantages of specialisation in expanding markets instead of looking for safeguards and job protection in a shrinking or stagnating environment. While there is induced protection when market expansion slows down, induced opportunities for openness, entrepreneurship and dynamism arise when market developments accelerate. Note, however, that induced protection does not only take the form of explicit or implicit cartels and voluntary restraint agreements, but also of government regulation and outright government intervention (in the name of orderly markets and fairness, usually at the expense of outsiders) and, equally important, in the form of government subsidies. Therefore, the growth opportunities needed to accelerate the productivity advance have to be actively opened up by deregulation and liberalisation in the economy and by privatising business and employment risks.

9. The time for such activities has come, for the following reasons:

(i) the expansionary monetary policy after the crash of October 19, 1987, gave rise to a demand boost all over the world, bringing about an economic tide that, so to speak, lifts all boats;

(ii) supply responsiveness is now being tested by the market;

(iii) the best means to fight inflation is to remove restrictions on the supply side and to make markets more open for more intense competition.

10. If timely measures are taken in the immediate future, Europe's trend rate of productivity growth could presumably be raised by a half and even by one percentage point to approximate the three per cent that Europe achieved a decade ago in the second half of the 1970s. This implies that the shortening of the work week which took place in response to the past decline of employment opportunities will be discontinued, though not reversed.

11. Several calculations by the Kiel Institute confirm that the order of magnitude may be right.

- An international cross section analysis of effective protection as it prevailed in the 1960s and 1970s leads to the conclusion that this protection did cost the world two percentage points in terms of economic growth foregone each year (Heitger 1987). The loss may have been lower for the industrialised countries and higher for LDCs with a catching-up potential.

- The very moderate tax reform in Germany to be completed by 1990 is estimated to have a positive supply effect of 0.2 percentage points of potential output growth (Boss 1988). More would have yielded more; and additional steps could be taken in the future.

- Finally, a programme of cutting subsidies - and simultaneously the income taxes needed to finance them - by half was estimated to substantially raise employment through its effect on the allocation of investment resources and on the overall productivity of investment (Gerken 1985).

12. A large scope for increasing total factor productivity could be presumed to emerge if government decided to shift the tax burden from income taxes to pollution taxes as the former

impair incentives while the latter have the positive side effect of raising total factor productivity as they are a superior substitute for the costly administrative pollution controls that are applied in Europe and that may well have contributed to the productivity slowdown.

13. The completion of the internal common market by the end of 1992 can be taken as a salutory productivity shock. The additional intensity of competition to be expected is likely to result in a faster productivity advance, apart from the upward shift in the path of potential output growth by two to three per cent that has been estimated to result, as a once-and-for-all effect, from the removal of border controls. Why should we then not anticipate a potential for four per cent output growth (per person employed) in 1993 and take this as a step towards a steeper path of potential output growth in subsequent years? An affirmative answer would, of course, be contingent upon supply increasing government measures, including privatisation and deregulation and a reduction of taxes and subsidies, and upon successful attempts to resist protectionist tendencies towards a "fortress Europe". More about this later.

14. A four per cent productivity advance in Europe may well mean less for the industrialised regions and correspondingly more for countries benefitting from a catching up process. When EUR 12 had a productivity growth of 4.5 per cent on average between 1960 and 1973, less industrialised countries like Greece, Portugal and Spain showed a much superior performance of around 7 per cent, i.e. fifty per cent better than the average. Would a productivity growth of 6 per cent in the lesser developed parts of the EC be out of the question if we anticipate strong tendencies to relocate the production of more or less standardised goods from the centre to the periphery after the markets for capital as well as for labour and goods have become really free in the post-1992 period? My answer is no; we should expect it.

15. But such relocation will happen at full speed only

(i) if the periphery is allowed to have wages and wage related costs low enough to fully match - and to temporarily overcompensate - the productivity differential existing vis-à-vis the more advanced centre, i.e., if - in other words - the periphery is allowed to exert its competitive advantage", and

(ii) if centre-periphery competition is not impeded by government subsidies to ailing industries in the centre.

## IV. The Role of Wage Policy

16. Wage differentiation between the centre and the periphery is thus essential for adequate growth. But it is also a necessary condition for an optimum allocation of resources in the spatial dimension. With inadequate wage differentiation, not enough jobs will move from the centre to the periphery and correspondingly more people will move to the centre and look for jobs there - waiting in desperate conditions at the outskirts of large cities or even in slum districts. Social upheavals and xenophobia, already now observable, may then become detrimental to European integration. This danger should warn us against the corporatist tendencies towards excessive labour market harmonisation.

17. The clue to Europe's problem of labour market integration and productivity advance is equilibrium wages at the periphery defined as wages

- o low enough to attract jobs from the centre,
- o low enough to attract capital from everywhere,
- o low enough to bring about the state of full employment within a limited number of years so that wages would then subsequently increase under the pressure of a high demand for labour.

18. There is no other road to full employment and fast productivity growth in countries with a high catching-up potential

than the path of relative wage moderation paved by unions in the centre of Europe in the 1950s under the pressures of a high capital shortage, unemployment and an Erhard-type moral suasion. Would it be tried again at Europe's periphery four decades later? Those who believe in learning from experience will be optimistic enough to give a positive answer. Here the EC Commission now has a great role to play.

19. In the industrial regions likely to suffer from the relocation of production to countries in a catching-up process, wage moderation is called for in tune with the peripheral countries, though, of course, in accordance with the higher productivity level the advanced countries have achieved. Such wage moderation serves the following purposes: In contrast to an aggressive wage policy

o it does not excessively push firms into relocation, thus preventing a wage induced export of jobs;

o it does not induce firms to defend their traditional locations by means of excessively capital intensive process innovations that destroy jobs before new ones emerge;

o it allows firms to concentrate on product innovations which benefit employment and - with some delay - permit wage increases as a result;

o it permits a wage drift and hence a stretching of the vertical wage structure which is important for offering workers incentives to undertake on-the-job training and to acquire higher skills;

o it gives firms greater scope for letting more employees participate in their profits, by itself a factor likely to raise productivity;

o it facilitates structural change at a higher level of employment by raising the effective demand for labour: instead of being dismissed into the pool of unemployed where their skills deteriorate, workers in declining industries have the option

- of keeping their jobs at relatively low wages for a longer time, or
- of accepting employment offers from firms in other lines of production or in other places where their skills are still highly valued;

o it induces firms to pursue an active labour market policy

- by paying generous fringe benefits to workers they want to attract from elsewhere, and
- by offering inexpensive training facilities to workers they need for more qualified jobs.

20. Wage moderation is thus an important element in any policy designed to accelerate the productivity advance - at any given level of employment. In other words: an excess demand for labour - at moderate wages - is more conducive to productivity growth than an excess supply of labour - at excessive wages. This is in accordance with Europe's experience in the 1950s and 1960s and may contribute to understanding Europe's productivity slowdown in the 1970s.

21. It may appear at first sight that wage moderation is disadvantageous to those who are employed, leaving apart the unemployed. But Europe's recent economic history shows the opposite. The explanation is this: fast productivity advance and high employment go together because active labour market policies pursued by employers - thanks to an excess demand for labour at moderate wages - is more efficient and socially more productive than active labour market policies pursued by governments - at higher wages and a deficient demand for labour. This is likely to be so for the following reasons:

o Under conditions of high demand for labour, workers are free to choose among different employers who, on their part, do the search and bear the search costs; this is more efficient than the reverse arrangement because employers are likely to have better information about future market prospects than workers; there are also good reasons to believe that a decentralised search and information system makes a better use of knowledge about ongoing structural changes in the labour market than a centralised system of labour offices under a government monopoly.

o If a worker decides to quit under conditions of full employment - at moderate wages - he does so in full awareness of the alternatives he has considered beforehand. This is in stark contrast to a dismissal under conditions of a deficient demand for labour - at excessive wages. In the latter case, the decision is more often taken by the employer who may have many selection criteria related to his own business, but not the criterion whether the employee to be dismissed has employment opportunities better suited to his skills elsewhere.

o It is true that employers do complain about an unduly high fluctuation rate (or labour mobility) when labour is in excess demand - at moderate wages. But such complaints can be taken to indicate a regret that investment in human capital which the firm has paid for will be used by another firm where the employee can cash in, at least partly, on the return on this investment. This implies that workers, though they have less information on the future market for their skills and may not take the initiative for investment in human capital, nevertheless can determine from time to time the direction that appears to them most in conformity with their talents and preferences.

o An excess demand for labour in the advanced centre of Europe - with high employment also at the periphery - will once again induce search activities with a view to attracting guest workers. It can be assumed that firms will then provide homes together with work opportunities and that workers who are prepared to emigrate to the centre will wait in their home region in expectation of search activities from the centre.

- o In the centre, the guest worker model offers a kind of imported labour market flexibility for the benefit of the insiders who can then opt for the easier forms of mobility: upward mobility in growing firms without changing locations or carriers.

To sum up and repeat: Wage moderation with demand pull from employers does promise better opportunities for productivity growth - at a given employment level - than wage pressure resulting in unemployment. It will make quite a few labour market regulations practically obsolete, thus amounting to a far-reaching liberalisation programme.

22. Wage moderation will also lead to higher employment. Indirectly it will occur by accelerating the growth of labour productivity as described. This enhances the direct effects which work through higher profits and higher profit expectations from the employment of additional workers. Any such employment effect will, of course, raise the rate of output growth beyond the four per cent productivity growth suggested as a reasonable target so far. Keeping this in mind, the following points indicate how the employment effect of wage moderation comes about and how it could be maximised:

- o Firms earn higher profits, and as profit earners have a higher propensity to save than wage earners, total savings are likely to go up as a percentage of GNP.

- o Higher profit expectations make domestic firms more eager to borrow for investment. More domestic savings will be absorbed at home, more investible funds will be imported. Europe's current account surplus will decline or even become negative.

- o The additional investment will involve the creation of new productive jobs that allow additional workers to permanently earn their income and yield profits that add to savings and investment.

- o Real wages rising less than productivity - i.e., higher profit expectations - will induce firms to hire additional workers for a more intense use of the existing capital stock, i.e., for a a higher capital productivity, a lower capital intensity of production.

- o A parallel effect will come about at the margin of growth - additional capital will have a larger job content and hence be more labour using and more capital saving.

- o With lower cost pressure, process innovations will appear to be less urgent; hence, more private resources can and will be devoted to product innovations that are employment creating rather than labour saving.

- o As a result of higher profit expectations, the demand for investible funds will increase more than savings so that the real rate of interest will go up. Contrary to widespread beliefs, a higher real rate of interest, if it comes about in this way, is employment creating as it induces investors to save capital (per unit of output and per unit of labour) so that a given amount of investment yields a greater number of permanent jobs.

- o Capital saving induced by a high real rate of interest can also take the form of investors preferring projects with a shorter depreciation period; and less durable investment makes for less technological obsolescence of capital (waste) at a given rate of technological progress.

- o This - together with a more labour friendly bias of innovations - can well accelerate the absorption of new knowledge by society.

23. This reasoning shows that Europe can make use of positive feedback effects that run from productivity growth to employment growth and from employment to productivity. These feedback effects seem to have been at work in the 1950s and 1960s; they were turned into a vicious circle in the 1970s and 1980s.

With determined efforts in the right direction, the vicious circle of the past can be transformed into a virtuous circle in the 1990s. The simulations underlying the quantitative estimates of the EC Commission's cooperative growth strategy take account of these effects though no simulation can cope with the complexities of a process of mutual reinforcement. This is why economists and other commentators of dynamic movements sometimes call miracles what they were unable to simulate ex ante.

24. The financing of the additional investment required for employment growth in EC Europe need not only come from the business sector, although capital mobility within the common market will contribute to making a better use of business funds. Other likely sources include:

- capital that will come in from abroad once it has become more widely known that Europe's equity capital is undervalued given its new growth prospects;

- foreign direct investment by international firms that will want to be in touch more closely with a prospering market;

- foreign loan capital attracted by a combination of monetary stability and high interest rates;

- government savings that will become available once public expenditures - thanks to lower defence needs and declining poverty - are outpaced by GNP growth;

- household savings that can be raised by shifting the tax burden onto consumption taxes - including taxes on the use of environmental resources - and by a restructuring of the social security systems with a view to giving more emphasis to individual self-responsibility and collective capital formation.

**V. Complementary Policies**

25. There may be strong tendencies in Europe to pursue trade policies that would attract direct investment from abroad as a consequence and to protect employment in sensitive industries. This would be the road to "fortress Europe". Nothing could be more shortsighted than this approach. A temporary boost to employment that might be achieved could definitely cost a high price in terms of slower long-run growth and productivity advance.

26. There are several reasons to support this: It is true that protection (import protection, subsidies and tax exemptions) for coal, steel, agriculture and textiles instinctively appeal to consumers who still remember wartime shortages of fuel, food and clothing and may, therefore, be prepared to pay for it. It is also true that whole regions in Europe - with strong voting power - still depend on these activities which once were the basis of people's prosperity. Finally, with eleven per cent unemployment in Europe, people and politicians find it difficult to believe that the resources used by these sectors have alternative uses which would yield sufficiently high returns. But it can be demonstrated

- that any protection against imports indirectly hurts exports in general - and hence employment in activities with high productivity prospects in the long run;

- that protection makes customer countries poorer - in the sense of being less prosperous than they would otherwise be - and therefore impairs the growth prospects of domestic export firms which concentrate on goods with a high income elasticity of demand, including capital goods;

- that subsidies and tax exemptions require higher tax rates in general and thus impair the incentive to work and to acquire skills and the propensities to save and to invest;

- o that aid in general - the supply of help - creates its own demand by inducing producers to lobby for aid and to anticipate aid rather than the structural change that inevitably goes along with economic growth in an open world order;

- o that aid in this way affects the mentality and impairs the dynamism of society.

27. The "fortress Europe" danger would hardly be worth mentioning in this context if the forces behind it were not inherently strong for the following reasons:

- o Protectionism is more deeply rooted in Europe than in North America because it fits the European traditions of corporatism: the guild tradition, the propensity to form cartels, the constructivist belief in design rather than market spontaneity, the anti-capitalist instincts, the preoccupation with self-sufficiency in times of war, the model of industrial self-governance under the guidance of government as applied on the continent in World War I and II, the utopia of industrial democracy. Corporatism requires continuous compromises among conflicting interests which can best be achieved at the expense of outsiders who are not represented at the bargaining table: the foreigners and the unemployed. To be sure, there are protectionist tendencies in the U.S. as well, and they are enhanced by the fact that the internal market on the other side of the North Atlantic is so large and will become even larger. But the ideological base of protectionism in North America is weaker as one can gather from opinion polls among members of the economics profession.

- o The road to "fortress Europe" is paved by the technocratic quest for ex ante harmonisation within the Community. In general: Harmonisation will come about in a natural way by people living more closely together and interacting more intensely with each other in a wider market without borders. Population groups still divided by national borders will speak more with one voice, use fewer interpreters, imitate each others' customs and habits more, move towards more similar norms of behaviour that reduce communication and transaction costs. Nobody can object to this harmonisation by trial and error, because nobody is excluded or forced to join. But if central authorities prescribe what norms should be adhered to, they must bribe or appease those who are inclined to object. The easiest way to do this is to combine these forms of ex ante harmonisation with restrictions on imports. Outsiders who do not comply will not be permitted to sell. It is true that minimum norms can well be justified on the grounds of preventing negative third party effects under the headings of safety, health and pollution control. But this is exactly what makes such norms, once they have been unified within the EC, an easily usuable base for new measures of import protection. The benefit of the doubt and of tolerance will surely be on the side of protecting insiders. The closing of the Community will then occur without much ado.

- Premature harmonisation will lead to a "fortress Europe" also in case of the so-called "Social Dimension". Surely, if Portugal can make itself attractive for foreign direct investment and if its economy warrants profit expectations high enough to generate an increasing supply of domestic entrepreneurship, then it will embark upon a fast process of catching up. This will - as stated above - involve a wage level low enough to quickly absorb the domestic unemployment. But exports on the basis of (temporarily) low wages from a less industrialized country may easily be denounced as "Social Dumping". This is exactly what is meant by this term in connection with the "Social Dimension". If it were otherwise, there would be no reason for raising the old "social question" in the new context. If the "Social Dimension" is more than rhetoric and if low wage countries within the Community are to be brought in line with less moderate wage policies elsewhere, they will have to be bribed or compensated. And as in the case of norms, an apparently costless compensation is always available in the form of protection against imports from outside, here against imports from countries which are even poorer and which have to pay an even higher price in terms of lost opportunities for catching up.

28. In conclusion: If Europe wants to make the best use of its own growth opportunities, it will have to accept more intense competition for its producers from outside as well as from within. The impact of competition on growth cannot be successfully modelled and simulated to fit the present case. It can only be imagined. But economists trained in the standard theory or resource allocation have little scope left in their minds for such imagination. In the trade field, they come up with static gains and losses that look miniscule, not high enough to convince trade negotiators and politicians that unilateral disarmament in the field of protection is worth any consideration. In other words: Harberger triangles, even by the heap, do not easily add up to a new high posture for a better growth perspective. Keynesian economists, on the other hand, tend to believe that supply is normally quite responsive to the exigencies of effective demand, thus belittling the danger of inflation. What is necessary in these circumstances is to build an intellectual bridge between supply-micro and demand-macro on Schumpeterian lines: Let us anticipate a higher growth rate in Europe on the basis of Europe 92 and move towards the opening of markets for more competition from inside and from abroad as the main element in an anti-inflation strategy.

29. On any anti-protectionist agenda for faster growth without inflation, agriculture will have to figure high. The road towards world market prices for agricultural products has to be travelled with increasing speed in the near future:

o to lower the cost of living increases that may well feed into wage and cost pressures in non-farm sectors;

o to reduce the wasteful surplus production in Europe and the financial burden arising from it;

o to lower the intensity of land use for environmental reasons;

o to make land available at lower prices for reforestation;

- o to release entrepreneurial talent from agriculture where it appears to be in a blind alley; and

- o to remove an obstacle to progress in the Uruguay Round of GATT negotiations.

30. Progress towards world market prices is inevitable. It could well be accelerated if landowners and farmers received full compensation - step by step and without delay - for the loss of net income or wealth they would suffer each time when prices were lowered. In order to simplify matters, a ten per cent reduction in the price of product A could be taken to imply a ten per cent loss in net income, assuming that the cost bill would be cut in proportion. Compensation could be granted in the form of a deficiency payment for a period to be defined or as a wealth compensation in the form of government bonds, with a nominal interest rate at the market level. A once-and-for-all switch to world market prices would not be excluded. In this case, down payments would have to be arranged for, and the best solution would then be to grant compensation in the form of government bonds so that landowners had the option to sell them and to make those investments that would become profitable at lower land prices.

31. The EC Commission would be well advised to set up an independent task force for solving the problems of agricultural reform - a task force independent of the agricultural lobby. If the CAP in its present form is wasteful, a faster move towards world market prices would be a gain for the taxpayer and consumer as well as for the truly entrepreneurial element in Europe's agricultural population. Most important of all, this reform would help to accelerate Europe's economic growth in the 1990s by reallocating resources and by making Europe more open to meet the challenges and to exploit the vast opportunities of economic growth in the world at large.

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