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INSTITUTIONS AND STRUCTURAL CHANGE
IN THE EUROPEAN COMMUNITY

by

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Addendum

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INSTITUTIONS AND STRUCTURAL CHANGE IN THE EUROPEAN COMMUNITY

I. Introduction

In any market economy a multitude of (partly interrelated) institutions intervene - directly and indirectly - into the functioning of markets in a myriad of different ways. In an economic integration scheme - such as the European Community (EC) - the case becomes even more complex since the network of national institutions is intertwined with a network of supranational bilateral and multilateral institutions. To deal with all these institutions separately would be a futile exercise. This paper rather provides an attempt to distinguish major actors, to determine the major thrust of their interventions, and to explain the driving forces behind institution building which have an impact on structures of production and resulting patterns of trade in the EC.

1. The Role of Institutions in a Market Economy

To set the stage for the subsequent empirical analysis, an analytical framework is required that allows to identify different types of interventions and to understand the behaviour of institutions. Throughout the paper, institutions are not understood as independent actors in the economic process - comparable to producers or consumers - but rather as the manifestation of a transitory compromise between widely varying groups of public and

private interest pressures. After some time of being in existence institutions may also develop certain self-interests and become interest groups themselves, though. With this approach the paper follows the main line of reasoning developed in the new political economy (see, e.g., Buchanan, Tollison, and Tullock, 1980).

Regarding the role of institutions, there seems to be a broad consensus among all interested parties that institutions are required to set and enforce the rules of the game in a market economy. However, even if institutions are confined to establishing a legal framework for individual activities of market participants they are by no means neutral with respect to the outcome of the market process. Regulating competition in one way or another always benefits some market participants and discriminates against others. For this reason, institutional interventions into the functioning of markets are subject to interest group pressures (Stigler, 1971) which intensify depending on actual or perceived effects of these interventions on group welfare.

Least controversial seems to be the need for an economic constitution. A number of generally public institutions are established to define and assure the basic functioning of the economic system, to provide internal and external security for economic transactions as well as to create a favourable external environment for individual economic activities by implementing appropriate macro-economic fiscal and monetary policies. All these institutional activities have a fundamental impact on the well-being of members of a society, but they are not considered in detail in

this paper since most of them do not intentionally benefit one sector over another.

Setting the rules of the game further implies to establish a framework for activities of sellers and buyers in individual markets. Supply and demand are subject to a host of technical standards, quality norms, safety and building codes, labour regulations, health requirements, etc., while access to markets is controlled by qualification requirements, regional and ecological considerations, anti-trust rules, business hour regulations, etc. There are a number of generally acknowledged reasons for constraining the activities of participants in individual markets such as health or safety considerations, but many of these indirect market interventions can only be derived from an individual rather than a collective welfare function. They often turn out to be means to reduce competition and to protect vested interests. Even health and safety requirements may serve the same purpose if they are excessive. Hence, it is not surprising that these rules of the game are subject to vigorous political debates and that there are changes of rules in response to changing constellations of pressure groups.

The relationship of interest group pressure and institutional intervention is most obvious in the case of direct interventions in the functioning of markets through:

- market participation such as government procurement,
- quantitative restrictions imposed on imports, exports, transfer

of capital, or migration of labour, and

- measures directly affecting prices such as fixing of prices or price floors and ceilings, centralized wage determination as well as measures indirectly affecting domestic (specific taxes, subsidies) or border prices (tariffs).

All market-specific interventions have an immediate impact on the structure of production since they favour sellers over buyers, one sector over another, or the domestic economy over foreign supply and demand. The type and degree of interventions implemented in individual markets reflects the relative bargaining power of market actors and their capability to organize themselves in politically influential interest groups which in turn may become institutions themselves (e.g. trade unions). Since the capability to organize themselves is not equally distributed among market participants (Becker, 1983) and since there may be collusion of interests in some markets but not in others, it is hardly surprising that degree and kind of institutional intervention varies widely among markets. Yet, there seem to be some common features for certain types of markets. In order to pinpoint such features of interest group pressures, the main actors and their interactions need to be elaborated a bit further.

2. The Major Actors

The network of institutions influencing market behaviour comprises not only different types of institutions with specific tasks but also essentially similar institutions at different

levels of competence ranging from the local to the international sphere. In the EC this network is extremely complex. Public, para-statal, and private institutions operate at least at five different levels of competence: there are regional, national, multinational European, European Community, and international institutions. As a general rule, the influence of institutions follows a hierarchical order, i.e., laws and regulations agreed upon at a higher level of regional integration beat those at lower levels of integration. However, the dividing line between responsibilities at different levels is not always clear and, more importantly, responsibilities have been shifted up and also down in the hierarchy over time. Since institutions at different levels of competence pursue different interests, these shifts have had a significant influence on the nature and thrust of regulations implemented in different markets. Therefore, envisaging future shifts of responsibilities are an essential element in the analysis if future perspectives of institutional influences on the structure of production in the EC are to be evaluated.

Shifts of responsibilities from one level to the other do of course not happen exogenously but reflect changing political or other pressures and the emergence of new interest group constellations. An assessment of institutional influences and their shifts and changes over time as well as of the timespan needed for changes requires to differentiate between different actors issuing different types of influence. At the surface, market interventions are implemented by public and private institutions assigned to do so by national or international law. In the public

sphere, these are local and national governments, agencies or treaties encompassing some, but not all European countries such as, e.g., the European Space Association (ESA), the various European Community institutions, and international institutions and treaties such as GATT, MFA, COCOM, etc. Beyond the public sphere, an array of private institutions are assigned certain tasks by law. These concern the establishment and supervision of norms and standards, health care as well as, in some cases, price negotiations and introduction of supply or demand constraints. Examples for the latter are in particular wage determination and labour legislation which - to a large part - is left to business associations and trade unions in all EC countries.

Over and beyond their direct role in market intervention all mentioned institutions influence the institutional framework in various indirect, though crucial ways. Bureaucrats in public institutions develop self-interests which do not only have an impact on the behaviour of their respective institutions but may turn one public institution into a pressure group vis-à-vis another public institution (Chubb, 1985). The competition for budget allocations is but one example for lobbying by public institutions which also takes place between different levels of competence within and among countries. The other category of lobbying activities concerns the influences business associations, trade unions, and sometimes even consumers are able to take on decision making of public institutions. Not surprisingly, pressure groups have organized themselves in accordance with the different levels of competence in public institutions, and the political power

they can wield depends, among other things which will be discussed below, on whether they pursue common or conflicting interests with respect to public decision-making. And finally, there is the heterogeneous group of voters which nonetheless may be able to have considerable impact on the behaviour of politicians, and through them on economic policies. Their influence again hinges on the degree of common interest among groups of voters and between them and organized pressure groups.

3. Stylized Features of Institutional Influences on the Structure of Production

Despite these brief hints about the importance of special interest groups economic science still has a long way to go to fully comprehend the political economy of economic decision-making. Yet, following the early work of Downs (1957), Buchanan and Tullock (1962), and Olson (1965), some basic principles of the political economy and some empirically meaningful hypotheses have been developed which can be used as an analytical framework for the relevance of institutional factors in EC countries. The economic approach to the behaviour of institutions assumes that actual policy choices are determined by the efforts of individuals and groups to further their own interest in a political market. Politicians or political parties are understood as vote maximizers, bureaucrats seek to enlarge their realm of influence, and pressure groups behave as rent-seekers for their members. Competition among these interested parties determines the equilibrium structure of market interventions such as taxes, tariffs,

subsidies and other political favours.

Politicians face elections in relatively short intervals of time and, therefore, tend to adopt populistic policy approaches to assure re-election. Populistic pressures are strongest at the local level, but may transpire to the national government if common interests of large numbers of voters are concerned. Bureaucrats may support populistic policies advocated by politicians as long as these promise to promote their own importance measured in terms of budget allocations (Niskanen, 1971). An additional problem arises, however, when national institutions are complemented by supranational institutions as is the case in the process of European economic integration. The question is which responsibilities national institutions are prepared to delegate to the supranational level. The answer is not clear-cut even if it is assumed that politicians behave as vote maximizers and bureaucrats seek to increase their budget.

Vaubel (1985) suggests that national politicians and bureaucrats view those policies as potentially dangerous to their image which benefit relatively small interest groups at the expense of the majority of voters, such as sector-specific tariffs or subsidies. Such policies are, therefore, likely to be shifted to the supranational level. This would give national institutions the excuse merely to execute measures agreed upon at a higher level which had to be accepted to further more general political goals such as European unification. Pelkmans (1983, 1986) presents a somewhat different viewpoint of the self-interest of politicians and

bureaucrats. According to his analysis, sector-specific policies are an important means to redistribute income and hence, a major instrument to influence the electorate. National politicians will seek to keep this instrument under their control and rather shift general economic policies such as the liberalization of tariffs to supranational agencies (for a similar interpretation, see Frey, 1984, p. 133). The reservation of national politicians against shifting responsibilities to supranational agencies may also be explained by the difficulty to control these agencies. Since the transfer of sovereignty represents a compromise between member governments, the performance of such supranational institutions can hardly be questioned by individual members later on. For this reason, international bureaucracy have a tendency to grow rapidly independent of the tasks they assigned (Frey, 1984, p. 151).

All explanations are plausible on theoretical grounds, and it is an empirical question which attitude of national politicians and bureaucrats actually prevails. The subsequent analysis of institutional influences in the EC is to provide some insights into the division of labour among institutions at different levels since the perspectives for future structural adjustment in the EC are heavily dependent on the actual behaviour of institutions.

The most important actors in the institutional arena are, however, organized pressure groups. These groups negotiate with governments and other institutions to obtain economic favours for their members, and they invest financial and other resources into

lobbying activities. It has been shown that this investment is profitable as long as the returns in terms of subsidies or other preferences exceed the returns from productive investment (Buchanan, Tollison, Tullock, 1980). The efficiency of each group in producing political pressure depends on a number of factors (Becker, 1983). It is the greater the better the group can control free riders and the smaller the group of beneficiaries is relative to the number of taxpayers or consumers as, e.g., in the case of farmers. Large demands by pressure groups may, however, stir resistence of those who have to carry the burden in the form of higher prices or taxes. Shifts of demand and/or tax avoidance would, then, limit the political success of pressure groups.

The identification of institutions and special interest groups and the analysis of their interrelationship allows to outline stylized scenarios of different types of institutional intervention depending on the interest group constellation in the markets concerned. The empirical meaning of these scenarios for the member countries of the EC will be discussed in the subsequent Chapter II.

The first scenario concerns declining industries and agriculture which are characterized by an accelerated depreciation of invested capital and a reduction of employment as a result of declining international competitiveness. In these markets, there is a collusion of interests among business/farmers'associations and trade unions which both stand to lose members in the process of shrinking output as well as voters in regions most affected by the loss

of competitiveness. Their combined political pressure is likely to be successful in achieving support from national, EC or international institutions, but - as Hillman (1982) and Cassing, Hillman (1986) suggest - political support may not be sufficient to entirely prevent industries from declining. The main reason for this limited success is essentially Becker's argument that the huge resources required to maintain previous output levels of ailing industries create incentives for those who have "to pay the bill" to issue countervailing pressure. Furthermore, all institutions are subject to budget constraints which cannot be overcome in the short run, and national institutions run the danger of retaliatory action by other national or supranational agencies. The empirical validity of these propositions will be scrutinized in Chapters III and IV below.

The second scenario encompasses technology-intensive and service industries which - in the context of the EC and other OECD countries - are potential growth industries. Yet, firms in these industries are supported by subsidies and/or restrictive trade practices. Respective business associations and bureaucrats seem to share in the intention to maintain or even intensify this support. Contrary to the case of ailing industries, these groups do not have to envisage much opposition from other interest groups since sunrise industries are prosperous, create new jobs and burdens of protectionist measures remain largely invisible to consumers and taxpayers. However, self-interest may lead to controversies among bureaucrats at the national and the supranational level. The final outcome of such controversies can hardly be

predicted purely on theoretical grounds. They may result in a simple shift of responsibility from one level to the other or they might induce a gradual process of deregulation. These issues are dealt with in Chapters V and VI.

The final scenario presents the struggle between mainly private institutions (mostly at the national level), i.e. the case of labour markets. National business associations and trade unions bargain over wages and labour regulations which have an immediate impact on the international competitiveness of industries and, thereby, the structure of production. Despite their obviously controversial interests, both negotiating parties have some common ground, too. They are both concerned with the viability of the industries concerned, the preservation of industrial peace, and the overall employment situation. Analytical questions are

- whether and under what circumstances one group can prevail over the other and introduce an institutional bias into the process of wage determination, and
- whether the ongoing process of European integration towards a true Common Market will give supranational institutions rights to enforce Community rules over national rules. Chapter VII attempts to provide an at least tentative answer.

The lessons from past behaviour of institutions and the forces driving their activities are summarized in Chapter VIII in order to evaluate the hypothesis that a multitude of intervention levels in the EC has compounded the impact of institutions on the

functioning of markets and added to distortions of the structure of production. This analysis also allows to assess perspectives for institutional change in coming years. The future direction of institutional intervention in structural change and foreign trade will depend to a substantial degree on the level at which economic policies are going to be formulated and implemented, i.e. whether tendencies for supranational integration or for re-nationalization prevail. Both tendencies are present in the EC context.

Finally, some major institutional barriers for the access of ASEAN countries to EC markets are identified, and some conclusions are drawn with respect to the impact of likely institutional changes on future ASEAN-EC economic relations (Chapter IX).

II. Structural Change in the European Community in the 1970s and 1980s from an Institutional Perspective

1. Driving Forces

In every economy, the structure of production is continuously changing in response to a multitude of demand and supply factors such as increasing per capita income, emergence of new domestic or foreign suppliers, new fashions, technological progress, shifts in the resource endowment, etc. The process of structural adjustment to changing internal and external parameters is geared by private and public policy decisions which influence prices and quantities in goods-, service- and factor markets. Policy decisions may either accelerate structural adjustment by lowering barriers to market access and allowing prices to reflect demand and supply changes, or delay adjustment by containing price fluctuations and regulating market entry and exit. The former decisions are forward-oriented and give incentives to resource flows from old to new industries, whereas the latter ones are defensive and protect employment and investment in declining industries. In reality, offensive and defensive adjustment policies are often implemented simultaneously in different sectors of the economy, and the overall economic performance then largely depends on which policy dominates.

The fact that there is no clear-cut adjustment policy in either direction can be attributed to the need of compromising with or balancing vested interests. In the EC, there are not only private

and public vested interests to be taken into account, but various national interests as well. In addition, supranational pressure groups compete with national pressure groups for resources and competence.

The need to compromise between supranational and national interests has several causes. National decision-making e.g. in capital and labour market policies co-exist with an irreversible transfer of power and sovereignty to the Community level in other areas of decision-making such as in agricultural and trade policies. This distribution of power requires some degree of policy coordination between national and supranational institutions. But, even when European law is binding for national policies, a large number of safeguards and escape clauses exists which prevent national interests from being overridden. Should unanimous policy-making not be possible, policy competence may be allowed to slip back to the national level, thus creating different policy frameworks in the various member countries. Alternatively, the European Court may have to decide ultimately when supranational institutions regard national policies as conflicting with the European treaties. Such conflicts can arise since European economic integration is in principle based on the harmonization of rules and regulations among member countries, but competition among regulatory systems of member countries is not permitted until harmonization is achieved. This means that goods and services can be sold and purchased in each member country under the rules of that country (designated country principle).

The first step in evaluating this institutional framework is to assess which policies have on balance determined structural adjustment in the EC. This analysis is based on production and trade patterns that have emerged in the EC in the last 15 years.

2. Sunset and Sunrise Industries

After a period of rapid growth in the 1950s and 1960s, industrial expansion slowed down considerably in all industrialized economies, but even more so in the EC. In 1972-1982, average annual growth of domestic demand for industrial products in the EC[1] amounted to only 2.0 per cent in real terms compared to 2.3 per cent in the US and 6.4 per cent in Japan (Buigues, Goybet, 1985a, Table 3). The following three years until 1985 yielded but a modest recovery for EC industries (2.4 per cent in the 1982-1985 average), compared to booming demand for industrial products in the US (6.7 per cent) and Japan (6.5 per cent). These discrepancies between the three major industrial economies suggest that beyond business cycles and problems to adjust to the external shocks of the 1970s, EC industries faced additional difficulties.

An explanation is provided by the above cited study on the competitiveness of European industries undertaken under the auspices of the EC Commission. This study distinguishes between industries

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[1] Here the Community is defined as EC7 comprising Belgium, Denmark, West Germany, France, Italy, the Netherlands and the United Kingdom.

facing weak demand[1] (sunset industries), moderate demand, and high demand growth (sunrise industries), and shows for the EC, Japan and the US that virtually the same industries fall into these categories in all three economies[2] (Table 1).

The essential disadvantage of the European industry pattern vis-à-vis Japan and the US concerns the relative importance of each of these categories. In 1982, sunrise industries represented only 23 per cent of total industrial value added (in real terms) in the EC compared to 28 per cent and 37 per cent in the US and Japan, respectively (Table 2). Furthermore, growth of sunrise industries measured in percentage points of total value added was lower in the EC than in the US and Japan, whereas the decline of sunset industries, albeit proceeding in all economies, was much less distinct in Europe than in Japan. Nonetheless, more jobs were lost in sunset industries of the EC than e.g. in respective US industries, and these losses were not offset by additional employment created in sunrise industries as it was partly the case in Japan (Table 2). Since the share of sunset industries in total industrial value added at current prices was fifty per cent higher than that of sunrise industries in 1982, the performance of sunset industries has largely determined slow growth of indus-

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[1] Demand is defined as real apparent consumption which was preferred over domestic final demand because it includes intermediate consumption of enterprises and general government.

[2] The only exceptions are the weak demand for rubber and plastic products in Japan and for transport equipment in the US.

Table 1 - Growth of Real Domestic Demand[a] in Manufacturing Industries in the EC, Japan, and USA/Canada, 1972-82, in per cent

	Belgium Luxemburg	Denmark	West Germany	France	Italy	Nether-lands	United Kingdom	EC7	Japan	USA/ Canada	Import market penetration[b]		Extra-EC exports ratio[c]	
											1972	1980	1972	1980
Industries facing														
Weak demand	1.4	-0.1	-0.1	-0.1	2.6	1.4	-2.1	0.2	3.0	0.5	8.9	12.7	8.6	13.4
Miscellaneous products	2.5	-1.0	-1.1	3.3	4.7	3.7	-1.6	1.3	1.4	1 8				
Textiles, leather, clothing	0.8	1.1	-0.5	-0.9	2.7	-0.4	-0.3	0.2	2.7	1.5				
Steel, metal ores	1.6	8.3	0.6	-0.7	3.5	-0.2	-0.7	0.7	3.7	-0.7				
Metal goods	1.8	0.6	0.3	-0.9	-0.2	2.2	-3.9	-0.5	4.2	0.0				
Construction materials, non-metallic minerals	1.5	-3.0	0.4	2.2	3.7	2.3	-3.2	0.9	1.8	0.3				
Moderate demand	2.5	1.6	1.4	2.3	2.8	4.4	0.3	1.9	4.8	2.3	6.6	8.5	10.9	14.9
Rubber and plastics	8.0	0.0	4.1	3.5	1.6	6.9	0.8	3.2	1.2	5.0				
Transport equipment	2.8	-1.2	3.2	4.7	5.8	0.6	-0.3	3.2	7.1	1.4				
Paper, pulp, packaging, printing	1.1	1.1	1.1	2.6	2.6	3.9	0.7	1.8	3.7	2.9				
Food, beverages, tobacco	2.2	3.1	1.1	1.5	4.0	5.8	1.2	2.0	3.8	1.7				
Industrial machinery	2.2	0.2	0.2	0.2	-1.0	4.0	-1.0	0.2	3.6	3.2				
High demand	6.0	3.9	4.9	5.7	7.1	6.2	2.9	5.2	13.5	4.8	9.3	17.0	16.5	22.7
Electrical equipment, electronics	1.8	0.1	3.5	5.9	4.3	5.4	0.6	3.7	15.1	5.5				
Information technology, automated office equipment precision instruments	6.8	7.1	8.2	7.4	16.0	7.9	7.0	8.9	6.8	5.7				
Chemicals, pharmaceuticals	8.3	5.0	5.1	4.9	7.7	6.9	3.9	5.5	11.8	3.7				
Total manufacturing	2.9	1.4	1.6	2.3	3.5	3.8	-0.2	1.9	6.4	2.3	8.0	11.5	11.1	16.0

[a] Nominal apparent consumption deflated by the index of the prices of value added in each sector (in US $ and at 1975 prices and exchange rates). The average current growth rate is calculated on the basis of data smoothed over two years: average for 1981-82 compared with average for 1972-73. - [b] Extra-EC imports as percentage of apparent consumption.- [c] Extra-EC exports as percentage of domestic production.

Source: Buigues and Goybet (1985a, Table 1), Annex Tables 4 and 5.

Table 2 - Sectoral Changes in Value Added and Employment in the Community, 1972 and 1982

	Sunrise industries		Industries facing moderate growth of demand		Sunset industries	
	1972	1982	1972	1982	1972	1982
	Percentage share in total industrial value added[a]					
EC 7	19	23	45	46	36	31
USA	23	28	45	44	32	28
Japan	22	37	33	31	45	32
	Absolute change in total employment 1973/1982					
EC 7	-437.6		-1098.8		-2712.3	
USA	-623.9		+384.4		-888.2	
Japan	+215.5		-84.4		-403.1	

[a] in 1975 prices

Source: As in Table 1, pp. 35 and 125.

trial output in the EC[1].

The findings of the Buigues/Goybet study clearly suggest that European policy-making was rather geared towards preserving sunset industries than towards facilitating the transfer of resources to industries facing high-demand growth. Delayed adjustment in the EC is reflected in the pattern of foreign trade which has important implications for interest group behaviour both in sunset and sunrise industries. In the latter group of industries, the market share of extra-EC imports has almost doubled from 9 per cent in 1972 to 17 per cent in 1982 (Table 1), which was higher than the respective shares for the other categories of industries. The opposite picture emerges on the export side. Although all industries have increased extra-EC exports (Table 1), only sunset industries were able to gain world market shares (i.e. higher shares of OECD exports)[2].

The losses of many industries in import and export markets are assessed by the specialization indices presented in Table 3. The EC has reduced imports in sunset industries and in industries facing moderate demand growth, relative to imports of all OECD

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1 There are notable differences in the performance of individual EC member countries, though. The UK was the only member state having experienced a negative real growth of domestic demand in total manufacturing, while Italy together with the Netherlands achieved top positions. Similarly, sunrise industries grew at 7.1 per cent on average in Italy and only at 2.9 per cent in the UK.

2 In sunset industries the share of the EC exports in total OECD exports rose from 25 per cent in 1972 to 29 per cent in 1983, while it dropped from 28 per cent to 26 per cent in sunrise industries and from 27 per cent to 26 per cent in moderate-demand industries (Buigues, Goybet, 1985a, Annex Table 6).

Table 3 – Structural Change and Foreign Trade Specialization[a] in the EC, 1983

	Import specialization 1983	Change[b] 1972–83	Export specialization 1983	Change 1972–83	Technology content[c]	Origin of extra-EC imports 1983: OECD	USA	Japan	Developing countries	South-east Asia	Destination of extra-EC exports 1983: OECD	USA	Japan	Developing countries	South-east Asia
Industries facing															
Weak demand	1.13	−0.04	1.11	+0.17		54.3	9.1	3.0	37.1	9.1	53.4	16.4	2.6	40.3	3.4
Miscellaneous products	1.38	−0.30	1.23	+0.18	n.a.										
Textiles, leather, clothing	1.10	+0.16	1.06	+0.13	low										
Steel, metal ores	1.12	−0.13	0.95	+0.10	low										
Metal goods	0.82	+0.17	1.32	+0.19	low										
Construction materials, non-metallic minerals	0.93	+0.05	1.21	+0.24	low										
Moderate demand	0.88	−0.04	0.97	−0.03		70.7	21.4	11.7	19.4	2.6	45.9	16.0	2.1	46.6	3.2
Rubber and plastics	0.68	+0.08	0.97	−0.11	medium										
Transport equipment	0.61	+0.20	0.84	−0.08	medium /high										
Paper, pulp, packaging, printing	1.49	−0.13	0.50	+0.04	low										
Food, beverages, tobacco	1.03	−0.42	1.00	+0.10	low										
Industrial machinery	0.92	+0.16	1.25	−0.05	medium										
Strong demand	1.01	+0.13	0.96	−0.11		81.5	35.9	18.8	13.4	5.4	48.2	12.0	3.0	41.5	4.0
Electrical equipment, electronics	1.10	+0.24	0.89	−0.08	high										
Information technology, automated office equipment, precision instruments	1.34	+0.23	0.64	−0.19	high										
Chemicals	0.83	−0.02	1.16	−0.02	high										
Total manufacturing	–	–	–	–		68.6	21.2	10.7	24.0	5.8	48.5	14.9	2.4	31.2	3.5

[a] Import (export) specialization:

$$\frac{(T_{i,ec}/T_{i,o})}{(\sum_i T_{i,ec}/\sum_i T_{i,o})}$$

where $T_{i,ec}$ and $T_{i,o}$ = imports (exports) of industry i of EC10 (from EC10) and of the OECD (from the OECD), respectively. – [b] Difference in import (export) specialization between 1983 and 1972. – [c] The technology content refers to OECD classifications as far as possible, otherwise information on German technology structures was used as proxy.

Source: Buigues, Goybet (1985a, Tables 4-7); Donges, Glismann (1987, Table 9).

countries in these particular industry categories and relative to total manufactured imports of the EC and the OECD. Export specialization has, on the other hand, increased for sunset industries as has import specialization in the case of sunrise industries[1].

These observations run counter to expectations, since under normal market conditions sunset industries are assumed to be phased out and sunrise industries to improve their international competitiveness. However, sunrise industries which largely comprise the high-tech sector have lost market shares abroad and at home, while labour-intensive and resource-based sunset industries were able to defend their position. This shows two things with respect to the policy framework in the EC. First, sunset industries have succeeded in obtaining a substantial degree of protection and, second, in light of their trade performance, sunrise industries seem to have a case for demanding institutional support.

3. Agriculture and Services

As far as non-manufacturing activities are concerned, both EC agriculture and services are subject to incisive policy interventions similar to sunset industries. On their way to a post-industrial society, European countries should on average experience a marked decline of agricultural activities and a steady

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[1] See also Koekkoek (1987) who concludes that in the 1970s the position of the EC in high-tech products was worse in exports than in domestic production.

expansion of the service sector with agriculture being a net-importer and services a net-exporter. Neither has happened so far in the EC as the empirical evidence shows.

As in all other major industrialized economies the share of the agricultural sector in gross domestic product of the EC has fallen (Table 4). In 1982-83, this share amounted to 3.9 per cent compared to 5.8 per cent in 1970-71. The point of departure between the EC and other industrialized economies is a rising share in world agricultural exports and a declining share in world agricultural imports (Table 4). Both changes of market shares point at the effectiveness of highly interventionist policies subsidizing agricultural exports and impeding imports from non-member countries in favour of intra-EC trade. As a result, import penetration of EC markets has more or less stagnated while agricultural exports expanded rapidly in order to find outlets for domestic surplus production of many agricultural products.

With imports from non-EC members heavily impeded and extra-EC exports artificially promoted, the decline in the contribution of the agricultural sector to total value added was less pronounced than it would have been without interventions. Consequently, resources have been absorbed by the agricultural sector which would have become obsolete under a less interventionist policy and would have been available for other activities. As will be shown below a number of vested interests allied in institutions and coalitions of institutions were active to retard and even to break the process of depreciating obsolete resources absorbed by

Table 4 - The Agricultural Sector in the EC, Japan and USA/Canada - Growth Performance and Foreign Trade Orientation, 1970/71 - 1982/83

		Share in total apparent consumption[a]	Shares in apparent consumption of the agricultural sector				Shares in GDP[b]	Share in world agricultural exports[d]	Share in world agricultural imports[d]
			Imports	Imports from developing countries	Imports from EC	Exports			
EC	1970/71	12.6	16.3[c]	7.6	6.2	2.2	5.8	28.3	41.7
	1976/77	9.8	21.4[c]	10.9	9.5	3.4	5.0	31.5	38.5
	1982/83	8.7	18.3[c]	8.7	10.8	4.4	3.9	34.3	36.5
Japan	1970/71	11.2	20.6	8.4	0.3	1.4	6.3	1.6	5.1
	1976/77	8.8	27.3	10.8	0.3	0.8	5.5	0.7	7.1
	1982/83	6.2	30.0	11.1	0.4	1.0	3.3	0.7	7.2
USA/Canada	1970/71	9.9	4.6	3.8	0.3	8.2	2.8[e]	16.6	16.5
	1976/77	17.3	12.8	9.5	4.5	5.2	3.3[e]	20.0	11.1
	1982/83	14.6	11.4	8.1	5.0	7.7	2.0[e]	16.3	13.1

[a] Apparent consumption in the primary sector and industry. - [b] 1970, 1975, 1983. - [c] Extra-EC imports. - [d] 1970, 1975, 1985. - [e] For USA only.

Source: UNCTAD, Handbook of International Trade and Development Statistics, 1979, New York 1981, and Supplement 1986, New York 1987. - Own calculations.

the agricultural sector in the EC.

Contrary to agriculture, the EC service sector seems to have been discriminated by interventionist and regulatory policies. A study prepared for the EC Commission (Green, 1985) reveals that the contribution of market services[1] to total gross value added rose from 38.8 per cent in 1970-72 to 42.3 per cent ten years later[2]. However, services have played a much larger role in Japan (46.2 per cent in 1980-82) and particularly in the US (49.6 per cent; Green, 1985, Table 1)[3].

The aggregate data veil substantial differences of service sector developments among EC member countries. Expansion of services depends, among other things, on the availability of resources released by other economic activities. If these activities are protected against decline, growth of services is constrained. Therefore, differences in the importance of service activities among countries do also reflect different degrees of protectionism, in particular for agriculture, manufacturing, and construction. West Germany and France have experienced the most distinct

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[1] Market services are defined as all services which can be purchased and sold on the market and which are produced by a unit which derives income mainly from the sale of its output. Thus, market services exclude collective services provided by governments or government institutions.

[2] Data refer to EC6, i.e. West Germany, France, Italy, United Kingdom, Belgium, and the Netherlands.

[3] A comparison of shares based on constant price data shows essentially the same magnitudes, except for the case of Japan. In this country, a very small increase in the price index of manufacturing value added relative to the price increase for market services caused the share of market services in value added to decline slightly.

expansion of market services, whereas in the UK and particularly in Italy (where a large amount of services is supplied by grey markets) growth of the service sector was much slower.

As far as trade in services with non-member countries is concerned, data available for the period 1975-82 indicate that imports of services measured at current prices grew faster than exports, so that the 1975 surplus of the Community in trade with services was reduced to virtually zero by 1982 (Green, 1985, pp. 87f.). With this trend continuing, the EC has become a net importer of services in the meantime, mainly due to rising imports of services like travel and property income not fully compensated for by traditional net exports of engineering and construction services.

4. Labour Markets

Structural change, output growth, and employment are interdependent. The allocation of capital among economic sectors and the pace of capital accumulation determine the number of jobs created or destroyed, while the price of labour crucially influences the direction and pace of accumulation. For these reasons, an analysis of labour markets has to be an essential ingredient of an overall assessment of structural change in the EC.

From an institutional perspective, labour markets are a unique case since wages are fixed and access regulations are negotiated by institutions representing the market participants themselves.

The scope for bargaining between employers and trade unions is, however, limited by public labour market regulations such as welfare legislation which has an impact on labour costs, and by public and private interventions in goods markets influencing the profitability of production. If the price of labour agreed upon by market participants exceeds the margin determined by product prices and technical progress, a fundamental imbalance is created which results in unemployment.

Such an imbalance has characterized labour markets of all EC member countries for more than a decade. Continuously increasing rates of unemployment ranging from 2.9 per cent in 1974 to 11.0 per cent 10 years later (EC9) accompanied by declining labour force participation rates[1] suggest that economic recessions in the wake of successive oilshocks, the emergence of competitive suppliers from labour-abundant countries, and delayed structural adjustment have not been adequately reflected in the movement of labour costs[2]. Declining profitability did not only endanger the competitiveness of companies particularly in sunset industries but also enhanced labour-saving technological progress even in relatively labour-intensive lines of production. The results of these interactions are most obvious in manufacturing industries. Another study by Buigues, Goybet prepared for the EC Commission

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[1] For men aged 16-64 the participation rate declined sharply from 89 to 82 per cent in 1973/83 (Emerson, 1986, p. 20).

[2] This is not to say that trade unions, employers or both are solely responsible for unemployment. One could argue that wage and other labour cost increases would have been consistent with overall economic development had structural adjustment not been hampered by a multitude of interventions.

estimates an industrial employment index of 80.3 for the EC as a whole in 1985, compared to a base period value of 100 in 1972. In absolute terms, 5.9 million jobs were lost out of a total of 30.1 million in this period of time. The opposite picture emerges for the US and Japan. In these countries, industrial employment indices increased to 103.5 and 105.8, respectively (Buigues, Goybet, 1985b, p. 39). Industrial employment fluctuated with business cycle movements in the US, but a high degree of flexibility in labour markets helped to create more jobs in phases of economic recovery than had been lost during recessions. In the EC, industrial employment continued to decline throughout recessions and recoveries (at different rates, though) and in all industrial sectors including sunrise industries such as information technology and electronics (Table 2). However, 60 per cent of all job losses accrued to sunset industries and half of these losses were incurred in the textiles and clothing industry.

Changes in employment are intimately linked to changes of wages on EC labour markets. With real wage increases of 2.4 per cent and 3.1 per cent per annum in sunset industries and in industries facing moderate-demand growth which were not balanced by increases of labour productivity, real unit labour costs in the two sectors have risen by 0.2 and 0.4 per cent per annum in the 1972-73 to 1981-82 period (Buigues, Goybet, 1985b, p. 50). After 1982, both moderate real wage increases as well as higher labour-productivity growth have contributed to reverse the former trend, however, without turning the tide back to levels of employment achieved in the early 1970s. The fall in real unit labour costs

in recent years as well as real devaluations of European currencies vis-à-vis the Japanese yen and the US $ (until 1985) have improved the cost competitiveness of European industries in world markets. Currency realignment had, however, affected competitiveness in a much more decisive way than falling labour costs.

Irrespective of these general improvements, many EC industries still suffer from relatively high labour costs and stickiness of labour markets compared to their competitors in other industrialized and developing economies. Inter-industrial dispersion of labour costs which should reflect skill differentials between industries were found to be much lower in the EC than in Japan or the US (Buigues, Goybet, 1985b, p. 47). Less inter-sectoral dispersion was in the main not due to differences in sectoral per capita productivity among the three economies, but to institutional barriers and wage bargaining based on non-sector-specific criteria in EC member countries. Wage indexing such as the "scala mobile" in Italy, uniform minimum wages for all industrial sectors, and the policies of trade unions to negotiate special wage mark-ups for low-skill wage categories on "social" grounds have all contributed towards levelling wage differentials among industrial sectors.

Insufficient wage flexibility has contributed to the rigidity of labour markets. Over time, inter-industry shifts of unemployment were much lower in the EC compared to the US and Japan. However, sectoral shifts of employment are also determined by policies enhancing or delaying structural adjustment. Support for ailing

industries reduces labour availability for potential growth industries, and thus exacerbates stickiness of labour markets. Since trade unions and employers' associations do not only negotiate wages but also lobby for protection in favour of declining industries, imbalances of labour markets have to be regarded as the result of a concerted action of private and public institutions. They co-operate in labour markets seemingly to preserve employment, but do in fact reduce the inter-industrial and inter-regional mobility of labour.

III. Policies and Institutions : The Case of Sunset Industries

1. The Policy Framework

In Chapter II the production of textiles and clothing as well as of metals (in particular iron and steel) and metal manufactures (e.g. shipbuilding) was identified as activities facing weak demand growth in the EC. All these manufacturing industries have to cope with heavy adjustment pressures as the result of excess supply and a rising competitiveness of a number of first and second generation exporters from developing countries. To facilitate adjustment, political support for these industries has been most vigorously claimed and conceded in the EC member countries. This is shown, for instance, by the degree of import protection granted to sunset industries through non-tariff measures. Nogues et al. (1985, Table 1c) have estimated that 52 per cent of EC textiles imports and 53 per cent of iron and steel imports faced non-tariff measures in 1982, compared to 19 per cent of total EC manufactured imports and 22 per cent of total EC imports.

The subsequent analysis focuses on iron and steel industries as well as on textiles and clothing. Political support for these two groups of industries is granted in different ways and in a different institutional setting. Early on, European countries have joined in the European Coal and Steel Community (ECSC) to coordinate their policies in what was considered to be an economic sector of vital strategic importance. Since the establishment of the ECSC in 1952, the framework for national policies in favour

of iron and steel industries was determined at the EC level, but this framework left ample scope for pursuing special national interests. A similar policy framework has been created for textile and clothing industries through the "Multifibre Agreement" (MFA) which is an international treaty sanctioned and surveyed by GATT, though not in accordance with GATT principles (Keesing, Wolf, 1980). Bilateral negotiations to be carried out under the MFA between exporting and importing countries are - in the case of the EC - under the responsibility of the EC Commission, but all recent agreements include separate quotas for individual EC member countries. Furthermore, safeguard and escape clauses included in the MFA as well as in agreements between the EC and individual exporting nations provide scope for additional national protection of textile and clothing industries. Hence, the analysis has to distinguish market interventions applied at the national, the EC, and the international level.

2. Price Interventions

Roughly speaking, means of policy support can be split into price interventions and quantitative restrictions. The former comprise the regulation of border prices (tariffs, variable levies, minimum prices) and/or of domestic prices (grants, subsidized loans, interest rate subsidies, state guarantees), whereas the latter refer to import bans, import quota, standards and voluntary self-restraints (VER), to name only a few.

Common to all declining industries in the Community is that border price interventions which are intended to raise lower world market prices to the level of internal EC prices did not play such an important role as in the Common Agricultural Policy (CAP) with its system of variable border levies. Though minimum prices for steel imports and countervailing duties on imports undercutting minimum prices were implemented in 1978, intervention prices were fixed on the basis of the cheapest world market supplier (Dicke et al., 1987, p. 66) and not on the basis of an internal EC threshold price as in the CAP. A French proposal initiated by the government's economic and social advisory board, the Conseil Economique et Social, to introduce a threshold price system for textiles and clothing in order to freeze import-apparent consumption ratios at a one-third level (Conseil Economique et Social, 1982, pp. 242-244) failed to find approval on the Community level. As far as tariffs are concerned, the EC clothing industry enjoys the highest rates of import protection granted to manufacturing industries. After the Tokyo Round, tariffs on clothing imports amount to about 16 per cent compared to an average tariff rate of 5-6 per cent for all industrial products. There is a widespread feeling, however, that these tariffs are largely redundant. In many EC member countries, non-tariff measures provide protection in excess of tariffs as was shown by Witteler (1986, Tab. 9) for the case of Germany.

The preference of policy-makers for non-tariff measures such as subsidized loans, grants and quantitative restrictions rather than for tariffs has several reasons. Compared to border price

interventions they can be introduced much more selectively (on a regional as well as on a firm basis); they are less exposed to international disputes and retaliation; and they directly affect the international competitiveness of domestic industries. In sum, non-tariff measures provide national authorities with more scope for discretionary action than a common trade policy would do.

Table 5 illustrates for textiles and clothing that there is a wide discrepancy among EC member states in domestic price interventions, both with respect to the structure of measures applied as well as to the level. In the early 1980s, Belgium took - under the so-called Claes-Plan[1] - the lead in subsidizing textile and clothing industries measured both in terms of subsidies per employee as well as per unit of investment, whereas West Germany and the Netherlands have intervened the least. As far as the structure of subsidies is concerned, France favoured direct grants, whereas Italy and the UK preferred grants to regions in which the declining industries dominate. State equity participation and R&D subsidies as well as access to subsidized credits were further tools applied by countries like Belgium and West Germany. What matters for the final analysis is the fact that relatively low levels of subsidies as in West Germany do not appear to have discouraged investment, while relatively high regional subsidies paid by the UK, for instance, obviously failed

[1] For a detailed analysis of the Claes-Plan, see Fels and Neu (1982).

Table 5 - Subsidies Paid by EC Member States to National Textile and Clothing Industries, 1980-83, in Mill. DM

Member state	Direct grants					State participation	Credits		Total subsidies		
	Sectoral subsidies	Regional subsidies	General subsidies	R & D subsidies	Total		Sector	Other	Absolute amount	per 1000 employees	as percentage of investment[a]
Belgium	21.5	75.0	-[b]	-	96.5	127.4	211.5	207.9	643.3	7.510	41.4
Denmark	-	0.6	7.7	0.8	9.1	-	-	27.7	36.8	1.510	14.3
West Germany	-	97.5	0.4	87.9	185.8	-	-	428.0	613.8	1.250	9.1
France	1033.1	-	14.2	-	1047.3	-	-	254.9	1302.2	2.520	28.4
Italy	-	384.8	-	-	384.8	27.5	218.8	211.2	842.3	1.780	13.9
Netherlands[c]	37.8	7.8	1.7	-	47.3	-	1.3	15.0	63.6	1.520	9.1
United Kingdom	5.9	781.8	19.0	49.1	855.8	2.7	-	20.1	878.6	1.950	24.0[d]
EC 7	1098.3	1347.5	43.0	137.8	2626.6	157.6	431.6	1164.8	4380.6	2.100	19.6

[a] Calculated on the basis of total subsidies excluding subsidies for R&D. - [b] General subsidies are contained in regional subsidies. - [c] Data for Netherlands in 1983 are partly missing. - [d] Estimated for 1983.

Source: German Ministry of Economics, mimeo.

to stimulate investment[1].

In institutional terms, price interventions in the form of subsidies have to be approved by the EC Commission. Disapprovals have in fact occurred, as e.g. in the case of sectoral subsidies for the British textile and clothing industries and in the case of the Belgian Claes Plan which had to be phased out after 1983 in response to a ruling of the European Court. Such attempts at policy coordination have not become the rule, though. Governments of EC member countries have largely maintained control over their subsidy programs in favour of sunset industries by either implementing approved forms of subsidies (e.g. regional instead of sectoral subsidies) or through indirect measures, such as equity participation, tax privileges, and financing of R&D expenditures. Such measures defy all calculation and notification.

3. Quantitative Restrictions

While price interventions in declining industries still seem to be more a national than a supranational domain in the EC, the most important set of measures available for intervention, the quantitative restrictions, solely falls under supranational competence. This is quite evident in the iron and steel industry where the institutional setting is determined by the Treaty on the European Coal and Steel Community. This Treaty assigns far-

[1] The UK paid 20 per cent of all EC member states' subsidies but achieved only a 15 per cent share of all investment in the industry, whereas West Germany maintained a share of 26 per cent in investment with a 14 per cent share in subsidies.

reaching competences to the Community such as (Art. 5) to allocate investment, to control prices and quantities, and to ration supply in times of crises. These provisions indicate that the ECSC Treaty provides the institutional background for a state-run European iron and steel cartel.

The ECSC has sought to facilitate structural adjustment and to maintain as many of existing production capacities as possible by sanctioning the formation of a "private" cartel (Eurofer) comprising (partly) nationalized European steel companies which were granted a large variety of company-specific production quotas, special trade regulations, and guaranteed minimum prices. In addition, iron and steel companies were supported by national subsidy programs. The Commission has fixed common rules for steel subsidies paid by the member states and achieved some transparency through notification procedures. However, time schedules for phasing-out these subsidies have never been realized since escape clauses always allowed for an extension of existing programs. National rates of subsidies still vary substantially among ECSC member countries, ranging from 26 per cent for Italian to 1 per cent for the German companies excluding the special case of the German steel company Arbed Saarstahl (Tarr, 1986).

Looking at time trends of institutional intervention, two observations should be kept in mind. First, national support programs for European iron and steel industries have continued to provide an essential cushion against competition from abroad despite the fact that the legal competence for iron and steel market regula-

tions rests with the Community. German companies which are the most efficient steel producers within the ECSC and, hence, do not require as much protection as steel producers in the other member countries, have repeatedly argued in favour of abandoning national subsidies, but politicians and bureaucrats have not yielded to their demand. Even the German government has hardly supported lower national interventions in the iron and steel markets. And, secondly, the steel industry has experienced a considerable adjustment process which includes the removal of excess capacity, firm concentration and an increasing share of government equity participation. Adjustment and protection were, however, not sufficient to prevent a further decline of these industries both in terms of output and employment levels (see also Chapter II), although iron and steel industries account for high value-added and employment share in economically backward areas ("rust belt") of all member states.

Textile and clothing industries are another important backbone of backward areas in Europe which have requested and received protection when suppliers from labour-abundant countries became successful competitors in world markets. The EC Commission plays an essential role within the international support framework established under the MFA as negotiating party for all member countries vis-à-vis exporting nations and as a "hawk" in successive rounds of MFA re-negotiations. The Commission agrees on bilateral VERs with all major producer countries to make the MFA framework operational. To date, a very complex and painstaking network of monitoring, surveillance, and consultations has been

built up covering more than 100 product categories for almost 30 suppliers with neatly defined quotas and ceilings[1].

Institutionally, the MFA represents a compromise between the desire of developed countries to grant unilateral protection to their textile and clothing industries on the one hand and GATT principles on the other hand. Given the incapability of the GATT to implement sanctions against unilateral protectionism, the compromise represents in essence an orderly marketing agreement regulating access to markets and volumes of trade flows, however, without direct price interventions.

Concerning the impact of the MFA, there is a vast body of empirical evidence documenting the allocative inefficiencies associated with the MFA for the world economy and the economic costs of the MFA for newcomers among the exporting countries as well as for consumers in importing countries (i.e. Keesing, Wolf, 1980; Wolf et al., 1984; Tarr, Morkre, 1984; Spinanger, Zietz, 1985). Despite these welfare losses, the MFA has been extended four times and became more selective and discriminatory, particularly for successful (so-called "dominant") suppliers:

- in MFA III (1982-1986), market access of dominant suppliers (Hong Kong, South Korea, Macao, Taiwan) was restricted in favour of other suppliers;

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[1] African, Caribbean, Pacific, and Mediterranean countries are included in a second window of this regulatory system. For these countries, quantitative constraints are largely replaced by mutual consultations.

- simultaneously, safeguards against unexpected import surges were introduced (and renewed in MFA IV) which provide national governments with an additional intervention mechanism;
- import quotas for the EC agreed upon in MFA I (1974-1977) were split up into separate quotas for each EC member country later on "to share the burden of cheap imports" (Davenport, 1986, p. 19).

The two latter changes reflect the growing influence of the national institutional level on the decision-making of both EC and GATT authorities. This process reflects vested interests deviating widely among member states with regard to the adjustment pressures which their textile and clothing industries are able to cope with. Apart from the introduction of individual quotas and safeguards in the MFA, there are other indicators which support the expectation that national interests will increasingly be taken into consideration by agencies at a higher level of competence. One such indicator concerns the modifications to the so-called escape clause provided for by Art. 115, EEC Treaty. This article concedes a temporary exemption (protection) from the Common Trade Policy to individual member countries if, in those countries' own perception, trade has led to an emergency situation for a domestic industry. In such a case, national governments are authorized to regulate the flow of goods within the EC by banning imports from specific third countries via other EC member states. This means in essence that by applying Art. 115, a member country can make national MFA quotas "waterproof", i.e. prevent the circumvention of national regulations through indi-

rect imports via other EC member states.

What started as a safeguard clause in the 1970s has turned out to be a permanent revolving system of trade barriers applied by individual EC countries mainly against Asian textile exporters (Langhammer, 1986, Table 7). The majority of claims to enforce national quotas with the help of Art. 115 has come from France and Ireland where garment factories are located in areas suffering from very high unemployment. In December 1982, France prepared a memorandum arguing in favour of an automatic application of Art. 115 each time indirect imports are observed (Europe, 1983). The EC Commission rejected this claim which was focused on textile exports from East European countries to France via the open border between the GDR and West Germany. The Commission still adheres to the initial interpretation of this article as an exception for emergency cases, but has de facto been very permissive in approving its application, as permissive as it has been in general with respect to the approval of national subsidization (Art. 92 III EEC Treaty)[1].

4. The Political Economy of Protection for Sunset Industries in the EC

Political support for sunset industries is requested and supplied

[1] Between 1975 and 1982, only 3.7 per cent of all applications for the approval of national subsidies were rejected by the Commission (Kommission der Europäischen Gemeinschaften, Zwölfter Bericht über die Wettbewerbspolitik, p. 122, cited in Vaubel, 1985, footnote 21).

on the national as well as the supranational level. These industries primarily turn to their national governments as the agencies which are most dependent on voters' behaviour and hence respond to lobbying activities. Since economic decline threatens both vested interests of capital and labour, trade unions join business associations in mobilizing political pressure. Their claim for protection measures is based on

- economic grounds: sunset industries in the respective countries would have been competitive if exports from competitors were not excessively subsidized (unfair competition),
- social grounds: sunset industries are regionally concentrated in backward areas, which do not offer alternatives for unskilled, immobile or otherwise handicapped workers,
- political grounds: a certain percentage of apparent consumption should be reserved for domestic production because of security reasons, and
- "moral hazard" grounds: governments would lose credibility (and voters) if they would abolish protection after many years of continued support.

The evidence presented above suggests that national governments tend to yield to such pressures, to varying degrees, though. They seem to respond in a particular pattern as the example of regional subsidies to the UK textile industry shows. Obviously, regional backwardness creates a stronger political risk than sectoral decline as such. Regional development directly and indirectly

affects large groups of voters and, therefore, the arguments in favour of ailing regions may carry more political weight at the national level than those in favour of ailing industries. In addition, specific forms of subsidies such as regional subsidies offer the possibility to implicate the supranational level and to share the financial burden of subsidies with EC budgets. The EC can be committed through the approval of grants from the European Regional Development Fund, the European Investment Bank, the "New Community Instrument", and the European Social Fund.

As a result, it is not only the Community competence in the external trade policy and the shelter provided by this policy which has brought sunset industries in Europe to form European lobby associations. Access to funds is also an important motive for common lobbying at the supranational level. In the case of steel, the common association, "Eurofer", was established by national governments, since quotas had to be negotiated and allocated between the national steel industries at the supranational level. In the case of textiles and clothing, European textile industries formed a Brussels-based "Coordinating Committee of the Textile Industries in the EC" (Comitextil) which for years has underlined the MFA's "great merit of having avoided the proliferation of unilateral restrictions and barriers to trade in textiles" and of enabling "the genuine LDCs to have access to world trade" (Comitextil, Bulletin 86/1, p. 1). In addition, Comitextil has lobbied for the release of Community funds for restructuring and modernization as well as for the coordination of national support programs (Comitextil, Bulletin No. 85/6, p. 10).

There may be conflicts of interest among textile industries in individual member countries to receive as much support as possible - even at the cost of textile industries in other countries - and with Comitextil pleading for support in favour of the textile industry as a whole. But conflicts can be mediated if both ways of seeking support, through national as well as supranational institutions, are accessible.

The principles guiding the division of labour between levels of competence are difficult to assess. There is some anecdotal plausibility for the hypothesis that national politicians prefer not to be identified with "dirty" jobs such as protectionism and tend to shift responsibility for implementation of these policies to an anonymous supranational agency. "Good" jobs such as the defense of a specific employment level in sunset industries by means of subsidies, are, on the other hand, kept at the national or even local level, since politicians would like to see themselves closely connected to them. Yet, the French hardliner position towards tightened protection for the French textile industry in excess of the commonly agreed level shows that member state governments may not hesitate to do "dirty" jobs themselves if domestic pressure groups are sufficiently powerful. Furthermore, budget constraints have to be considered. If constraints in the Community budget become more binding than in national budgets, "positive" (from the voters' point of view) policy measures such as subsidies continue to be implemented at the national level, while "negative" policies, i.e. impeding market access for imports, which have non-pecuniary costs "only", are shifted to the

supranational level.

All in all, the experience with the division of labour between national and supranational institutions in supporting sunset industries in the EC suggests that the Commission has been assigned a role mainly in improving the transparency and compatibility of restrictions by setting guidelines rather than in removing them. Unless all member states unanimously endorse more competition between their national industries, which can, of course, imply the collapse of some industries in backward areas, the Commission will not be able to discipline member governments and succeed in refraining national Ministers of Finance from competing with each other in a subsidy race. In other words, while the formal competence for restricting entry of third countries to EC markets rests with the Community, it is rather the member states which politically determine the level of price and quantitative interventions actually applied. Approval of national subsidization (Art. 92 EEC Treaty) and national escape clauses (Art. 115 EEC Treaty), both permissively applied, lead to a de facto renationalization of interventions.

IV. Policies and Institutions : The Case of Sunrise Industries

1. A New EC Competence in the Making

Industrial activities falling into the category of sunrise industries, i.e. industries with a high degree of international competitivenes in advanced economies in the medium-term future, are not easily identified. Manufacturing industries which have been growing rapidly in the past must not necessarily be future industries since a simple extrapolation of past growth does not take into account new products emerging through technological progress, shifts of competitiveness among locations as a result of factor mobility, and changes in consumption patterns. For all these reasons, sunrise industries can only be characterized in very general terms as activities with a high human capital and a high technology content. Examples are the production of communication and information technology or aerospace industries.

Given the lack of criteria for defining sunrise industries the whole concept of government intervention in favour of these industries becomes doubtful. Governments do not dispose of more knowledge about future technologies, products, or demand patterns than private enterprises, and this knowledge is necessarily scanty and uncertain. It is a process of trial and error which finally determines viable sunrise industries. Government support for emerging sunrise industries would, however, require some basic information as to when this support is warranted and effective. Hence, it is not surprising that national subsidy schemes for

research and development (R&D) focus on already existing technologies and products; they tend to support the leading suppliers of technologies rather than the potential ones.

So far, so-called technology policies were mainly implemented at the national level and under the auspices of special treaties involving some, but not all EC member countries. At the Commission level, the degree of interference is still low, if EC expenditures for the agricultural sector or the steel and textile industries are compared to expenditures for R&D activities in high-tech sectors. In 1982, the EC research budget accounted for 2.5 per cent of the total budget compared to almost 70 per cent for the agricultural sector. Yet, this may change. The demand for competence and resources at the Commission level is rising. The "creation of a European research area" (Europe Documents, No. 1275, p. 5) is on the agenda especially since the Milan meeting of the Heads of State in December 1985. In this meeting a European Technology Community was envisaged to overcome a supposed fragmentation of the EC in research and technology issues and to strengthen the international competitiveness of the industrial sector. The Heads of State endorsed what already was the feature of the R&D framework program of the Commission for 1984-1987, namely the policy shift away from the traditional preponderance of nuclear research towards research promoting industrial competitiveness (Europe Documents, No. 1275). The Single European Act (signed in Luxembourg in February 1986) which commits the EC to achieve a fully integrated internal market until 1992 also includes the objective to improve the scientific and technological

foundations of the European industrial sector. This objective had been integrated into the 1957 EEC Treaty (Art. 130 seq.) and constitutes the legal basis of a new EC competence the status of which is seen as comparable to the EC responsibility for the common trade and transport policies (Narjes, 1987, p. 268). The 1987-1991 R&D framework program of the Commission is expected to substantiate this new competence by providing subsidies for industry-related R&D.

2. National Support Programs

On the national level, individual member states apply price interventions as well as quantitative restrictions. Domestic price interventions comprise subsidized loans and grants for R&D expenditures of both public and private companies. Table 6 records R&D appropriations in EC member states in 1975-1984 as well as their shares in GDP and total budget[1]. Measured in terms of shares, France, West Germany, and the UK have incurred significantly higher expenditures than the other member states. Yet, in terms of growth rates, R&D expenditures have stagnated in West Germany while they have continued to rise in the other two member countries. These Big Three also have contributed the lion's share to the common EC budget for R&D (more than 80 per cent). In 1983 - before the new Commission competence was launched - this budget

[1] Expenditures for military R&D account for about one quarter of total R&D expenditures in EC member states. This average share disguises large differences among member states with the UK (about 50 per cent) and France (about one third) as the two countries with the highest proportion of military R&D (Table 6).

Table 6 - R&D Expenditures in EC Member States, 1975-1984

	R&D appropriations tions in 1983 at current values and exchange rates (million EUA)		Government R&D appropriations at 1975 prices and exchange rates						Ratio of government R&D appropriations to total budget		Ratio of government R&D appropriations to gross domestic product	
			Annual average rate of change in per cent				Contribution of member states to the Community total in per cent		in per cent		in per cent	
	total	civil	total 1975-1983	total 1983-1984[a]	civil 1975-1983	civil 1983-1984[a]	1975	1983	1975	1983	1975	1983
West Germany	8 407	7 599	0.0	-0.9	0.2	-1.2	36.3	30.6	4.37	4.12	1.23	1.15
France	8 182	5 509	3.4	5.7	2.8	8.4	27.7	30.6	5.50	5.97	1.17	1.43
Italy	2 802	2 642	10.5	9.6	10.1	6.4	4.9	9.1	1.40	1.41	0.36	0.70
Netherlands	1 510	1 465	1.9	0.7	2.0	0.7	5.6	5.1	3.15	2.48	0.96	1.02
Belgium	537	535	-2.6	-2.7	-2.5	-2.7	3.2	2.2	2.23	1.34	0.73	0.60
United Kingdom	6 814	3 466	2.2	7.6	1.5	11.3	20.6	20.7	2.86	3.19	1.27	1.36
Ireland	82	82	1.8	1.5	1.8	1.5	0.2	0.3	0.94	0.80	0.44	0.43
Denmark	325	324	-0.2	1.5	-0.2	1.5	1.6	1.3	1.76	1.43	0.58	0.51
Greece	78	78	-	-	-	-	-	0.2	-	0.55	-	0.20
EC 10	28 736	21 700	2.2	3.9	1.9	4.1	100.0	100.0	3.59	3.20	1.03	1.12
EC budget	463	463	-	-	-	-	-	-	-	-	-	-

[a] Provisional budgets for 1984.

Source: Eurostat, Government Financing of Research and Development 1975-1984. Brussels, Luxembourg 1985.

accounted for only 2 per cent of total national R&D expenditures.

On average, more than forty per cent of EC 10 appropriation for R&D were spent on basic research followed by research for industrial production and technology (almost 16 per cent) and energy utilization (14 per cent; Eurostat, Government Financing, 1985). Between 1975 and 1984, this ranking did not change significantly, but expenditures for industrial production slightly gained in importance at the expense of support for basic research.

Non-tariff trade barriers at the national level such as standards and government procurement discriminate against suppliers from other EC member states as well as from third countries. These practices have been subject of debate among EC member countries. In particular the French government views national trade restrictions as a disadvantage for EC suppliers vis-à-vis those from the US and Japan. Each of these two countries has a larger technology market than any single EC country, and technology industries can realize economies of scale in these large markets. In a proposal for the creation of a "unified European industrial and scientific area" (European Documents, No. 1274) the French government has suggested a gradual liberalization of government procurement, however, only with respect to suppliers from other EC countries.

It is very doubtful whether such a change of incentives could really improve the competitiveness of European high-tech industries. Regional procurement combined with a harmonization of European standards required for achieving a fully integrated

internal market by 1992 amounts to a regional import substitution strategy with less rather than more openness of markets and, hence, less competition. If technological development in the EC is delinked from world markets, a doublification of research efforts is inevitable.

The economic impact of standards and government procurement cannot be measured empirically. According to the GATT inventory of non-tariff measures (GATT, 1981), the US, Canada and Japan have notified discriminatory practices in government procurement of almost all EC member states[1].

As no GATT actions were taken so far and as consultations are still pending, it is not possible to assess whether the notifications were justified. However, interventions are likely to be concentrated on foreign trade in those manufactured products which are not subject to the GATT Agreement on Government Procurement since the EC is a contracting party of this agreement. Many of these products belong to the high-tech category such as

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[1] These notifications referred to Belgium and Luxembourg (general discrimination of non-Benelux countries), Denmark (discrimination of non-EFTA countries against EFTA members who are set equal to domestic firms), France (discrimination in nuclear energy and aircraft industry, electronic data processing equipment through refusal to issue the necessary technical approvals and visas to foreign products), Greece (general discrimination of foreign suppliers in international bidding unless bilateral clearing arrangements and compensation agreements exist with the supplying country), Italy (discrimination of foreign suppliers in areas which are not covered by the GATT Agreement on Government Procurement, e.g. telecommunication, transportation, power generation and transmission sectors), United Kingdom (general discrimination against Commonwealth suppliers, preference given to national computer manufacturers).

telecommunication and power generation equipment.

3. Bilateral Institutions

The second level of intervention concerns the co-operation of several, but not all EC member states in joint high-tech projects. The Airbus and Ariane programs for the production of European aircraft and launch vehicles are the most prominent cases in point. Comprehensive national price interventions through public equity participation and interest rate subsidies as well as quantitative interventions (discriminatory sub-contracting in favour of EC-based firms, purchase guarantees, government procurement) have been required to make the Airbus project a "success", at least in terms of market shares. It would go beyond the scope of this paper to record the Airbus saga in detail[1], but the following facts highlight the nature of this inter-country co-operation.

Airbus industries were established in the late 1960s and are owned by the French Aerospatiale (with a 37.9 per cent equity share), the West German MBB (37.9 per cent), the Spanish CASA (4.2 per cent) and, belatedly, the British BAE (20 per cent). Associate members (i.e. sub-contractors) include the Dutch Fokker, the Belgian Belairbus and SOKO of Yugoslavia. The idea was to develop an economically viable aviation industry by guaranteeing national orders from each member, by sharing R&D over-

[1] See for details, Rallo, 1984; Todd, Humble, 1987, pp. 39-42).

heads among partners, and by achieving economies of scale through boosted production runs, i.e. lower unit costs. By 1978, the future of Airbus industries was assured when official acknowledgement came from the EC Commission (documented in the "Action Programme for the European Aeronautical Industry") and economic support was granted by the French government through a large order from Air France (Todd, Humble, 1987, p. 40). By the mid-1980s, the Airbus had gained a 19 per cent share in the market of leading Western airlines.

The economic costs of this "success" have been enormous and will not be recovered through sales of aircraft. Although subsidies amounting to more than 10 billion US $ have been paid, the target of achieving a break-even point has continuously been failed. The more aircrafts were ordered, produced, leased and sold, the more frequently break-even points were adjusted upwards. Furthermore, increasing sales nourished the desire to consolidate market shares by adding costly new aircrafts to the already existing fleet[1]. The consequence is a permanent pressure of participating companies on government authorities to grant further subsidies and to find new partners for the joint venture[2].

The projects Ariane (launch vehicle), Hermes (space shuttle) and

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[1] First, wide-body jetliners complemented narrow-body (single-aisle) ones; now long-range aircrafts are in the making adding to the medium-range types.

[2] The recent pressure of the West German Ministry of Economics on the West German company Daimler-Benz to participate in the airbus project (and its losses) is a case in point.

Columbus (orbital platform) are expected to face the same dilemma of being permanently dependent on public assistance though the projects are scheduled to operate in a commercial satellite market. Notwithstanding all rhetorics about European co-operation, there is a good deal of rivalry between the large participating member countries (France, UK, West Germany) with respect to prestige gains to be achieved from apparently successful high-tech projects, and this rivalry has a strong political impact on the readiness with which further national subsidization schemes will be implemented.

4. Actors and Policy Trends at the EC Level

The spread of sub-contracting activities in multilateral inter-country projects over almost all EC member states and the claim of Community institutions for a competence in European technology policy are indicators that the EC Commission will become actively involved in European aviation and aerospace industries in the future. At present, EC technology policies focus on sponsoring European-based high-tech projects in the area of information technology. It is interesting to note that the respective programs were only launched after 1981 when the Japanese Ministry of Trade and Industry (MITI) announced the joint development of a "fifth computer generation" together with the Japanese electronics industry. In response, the "European Strategic Program for Research and Development in Information Technology" (ESPRIT) was established in early 1982. At that time, the main technological bottleneck in the EC vis-à-vis Japan was assumed to be in the

semiconductor industry. Therefore, R&D subsidies granted under ESPRIT were concentrated on advanced microelectronics, software technology, advanced information processing, office systems and computer-aided manufacturing[1].

Unlike national R&D programs in information technology (in West Germany, France and the UK) for which only domestic enterprises are eligible, ESPRIT programs require the participation of at least two independent industrial partners which are not resident of the same member country (EC Official Journal, 9 March 1984). This requirement discriminates not only against non-EC-based firms but also against smaller EC firms which cannot bear high information costs and uncertainty associated with searching for an appropriate foreign partner company. It is not amazing that 26 out of 36 pilot projects have been carried out by five large European companies (Schneider, 1986, p. 683). In addition, 75 per cent of the available funds are reserved for large-scale projects.

Even if some public assistance may be economically justified on account of technological indivisibilities, long gestation periods and high failure risks associated with large-scale projects in information technology, lobbying of large companies has played an essential role in the establishment and subsequent expansion of ESPRIT. A clear sign for their influence is the fact that representatives of these companies are members of the management group

[1] The EC Commission normally bears 50 per cent of the costs of ESPRIT projects.

deciding on the acceptance or refusal of project applications. Lobbying for ESPRIT and similar programs pays for private firms, since access to public funds does not only reduce their own R&D expenditures but also helps to externalize information costs.

In spite of initial resistance, member governments which have to finance the subsidies and to abandon part of their own competence have finally endorsed the ESPRIT program as the number of firms applauding the Commission initiative and participating in joint projects increased rapidly. Compromises between member governments on the definition of "European" firms[1] paved the way to an approval of the basic principles of ESPRIT by the Council of Ministers in 1984. Thereafter, the political objective to initiate European technological co-operation has led to the implementation of a number of further programs for an increasingly narrower and more precisely defined range of products which are supposed to be essential to future growth of manufacturing industries. There are subsidies to promote the development and diffusion of new technologies (BRITE) and of telecommunication (RACE), as well as special projects carried out under the auspices of the "European Research Coordination Agency" (EUREKA). The concentration on individual product categories facilitates to enforce the impact of financial support by complementing barriers against imports from third countries such as tariffs or NTBs. Since such policies also are under EC competence, the EC Commis-

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[1] France demanded to confine the release of funds to "authentically" European firms in order to exclude IBM but finally approved a broader definition.

sion can, at least potentially, wield a considerable amount of power with respect to controlling market entry.

The comprehensive competences of the EC Commission create an incentive for both public and private interest groups to lobby for all-encompassing protection. The French government has already suggested to use the common trade policy for European industrial development which in essence means infant-industry protection for high-tech products[1]. If supported by a more permissive stance of the Commission with respect to its competition policy in high-tech sectors, as was already requested by the Union of Industries of the European Community, UNICE (Europe Documents, No. 1281), the result would be a further step towards shackling European industries to their home markets.

5. Perspectives for the Future

In the 1980s, institutional support for high-tech industries has been geared towards two objectives. The first was to protect domestic suppliers against an increasing market penetration by in particular US and Japanese firms which enjoy an actual or perceived lead in specific technologies such as information technology or consumer electronics. Subsidies and NTBs have provided breezing space for domestic firms to re-invent and imitate, but hardly paved the way to new technological break-throughs which

[1] See Europe Documents, No. 1274, p. 4, where the case of a European "compact disc" manufacturing program and its tariff protection is taken as an example.

would have improved the competitiveness of European companies on international markets. This type of institutional intervention which preserves existing structures of production and hampers economic growth seems to reflect the joint interests of bureaucrats to increase their influence through direct market interventions, and of the concerned firms to defend their markets[1]. Since these activities remain largely unnoticed by consumers and taxpayers, there is no pressure group for more competition in high-tech markets. The only opposition to present technology policies comes from those few firms which have succeeded in achieving international competitiveness without government assistance such as the German Nixdorf company.

The second objective of European technology policies concerns the orchestrated development of new products in European joint ventures with both national and multinational institutional support, such as in aviation and aerospace industries. European technological independence, regional security, economies of scale, and technological indivisibilities are key words of the rhetoric in favour of European technological co-operation. Given the political decisions to support large-scale multinational R&D projects, facts and expectations have been created which are hardly reversible without substantial losses of investment and employment. Future subsidy payments for these projects have, thus, gained the quality of entitlements which makes it easy for industrial and

[1] In most European countries, these interests are even merged institutionally since e.g. postal and telecommunication services are supplied by state enterprises.

political pressure groups to lobby for continued and increasing assistance irrespective of efficiency considerations.

Both the preservation of established market shares and the development of new technologies has required ever larger budget appropriations as did the support for declining industries (and agriculture). Over time, budget constraints made it unavoidable to set priorities and, as a result, technology policies have gradually been shifted from the national to various supranational levels. Since the opposite tendency was observed in the case of declining industries, one has to conclude that national politicians do in fact prefer to control those policy measures which seem to have a visible effect on the well-being of their voters. If this effect is less visible and hence, does not immediately bolster the standing of politicians in the eyes of the electorate, political decision-making powers are pushed upwards to anonymous multilateral institutions as Pelkmans (1986) has suggested.

In light of these past trends, it is most likely that future conflicts of interest at the national level and also in joint projects such as Airbus or Ariane will be resolved by strengthening the role of the EC Commission. A common EC technology competence facilitates financial burden-sharing in two ways: it increases the number of payers (i.e. the EC taxpayers in total), and the Commission can intervene in terms of future commitments rather than current payments. However, settling conflicts about financing does not rule out conflicts about objectives. France

strongly advocates the expansion and deepening of the internal market in high-tech sectors, but other member states do not seem to have a similar clear-cut policy stance. The Commission is leaning towards the French position and suggests a number of areas for policy action to improve the international competitiveness of European firms (Europe Documents, Nos. 1275, 1277)[1]. It remains to be seen whether the EC technology policy will go further down the inward-oriented path.

[1] The Commission proposes four key areas: improving the economic and monetary framework basically by strengthening the European Monetary System; the "dynamic use of the common market"; scientific research and the development of advanced technologies; and energy policy.

V. The Role of Institutions in the Agricultural Sector

1. The Common Agricultural Policy (CAP)

Following Engel's law of shrinking shares of food consumption in rising income, and as a result of the scarcity of land in the EC compared to other parts of the world, both demand and supply conditions have been unfavourable for agricultural production in Europe since long. Declining agricultural incomes and employment have, however, always been found difficult to accept in the general public and in politics for a number of strategic, social and, recently, environmental reasons. Food security, market failure, preservation of ecological balances, and the plight of small and medium-sized farmers are frequently mentioned, though ill-conceived arguments in favour of protecting the agricultural sector against structural adjustment. What matters more than these arguments from an institutional point of view is the fact that farmers have always been a fairly homogeneous political group which could be easily organized in effective pressure groups because of their small numbers and their strong common interests. Most political parties in EC member countries (rightly or wrongly) believe farmers to be an indispensable part of the electorate and hence, compete for their votes by bending to farmer's demands.

Against this background, it is hardly surprising that the agricultural sector enjoyed strong political support in all EC member countries long before the EC was founded. Institutionally, this

sector was ever treated as a "case sui generis" in the sense that income and employment goals were explicitly stipulated by law. To give a few examples, the German Law of Agriculture (Landwirtschaftsgesetz) of 1955 commits the legislative authority to implement economic policies geared at maintaining an income parity between agriculture and industry. The French "loi d'orientation d'agricole" of 1960 constitutes the ideal of family farmholdership and determines income parities between agricultural and non-agricultural sectors as well as social security for the agricultural labour force (Treiber, 1983, Chapter 8). Even in the UK where policies are generally characterized by a lower degree of government interference than, e.g., in France, the White Book on "Farming and the Nation" of 1979 justifies the release of public funds for expanding domestic agricultural production by the necessity to improve autarky as safeguard against unexpected shortages (MAFF, 1979).

These laws establish entitlements which are not easily changed even if budget constraints become binding and/or external commitments would require a re-orientation of agricultural policies. The most important external commitment in that respect originated from the foundation of the EEC. Economic integration among countries with widely varying degrees of agricultural interventionism and different resource endowments[1] could only be achieved by ei-

[1] The Community has included countries with high consumer prices and very high production costs such as West Germany, countries with a low degree of autarky and low consumer prices (UK), as well as countries with low production costs, low consumer prices and net export surpluses in crops (France, Italy) or in livestock (Netherlands).

ther exposing national regulatory systems to inter-country competition or by coordinating national policies through a supranational authority with an independent legal sovereignty. The first avenue, the introduction of the "country of origin" principle, was politically not feasible since it would have exposed the agricultural sector in high-cost countries to tremendous adjustment pressures. The second approach to integration, a common market for agricultural products, allowed to chose among three options: common rules for competition, binding coordination of different national market regulations, or the introduction of a common (legally defined) market regulation (Art. 40 EEC Treaty). The first option would have resulted in some efficiency gains depending on the level of the external protection agreed upon by the member countries. The second would at least have kept differences among national intervention levels constant, and the third - in economic terms the least efficient one - means in essence to establish the highest respective level of national interventions in all partner countries. This latter solution was supported by France, whereas West Germany argued in favour of the second option. After serious controversies during the transition period a compromise was forged. France agreed to a customs union for industrial products and Germany as well as the other member countries conceded common market regulations for agricultural products, which were first introduced in 1962 for cereals, pork, eggs, chicken, fruits and vegetables, wine, beef, milk, dairy products, and sugar.

The common elements of all market regulations are external trade

protection through variable levies and export subsidies to lower high EC export prices to the world market level. Furthermore, producer prices are politically fixed for each product, and these administered prices also determine EC threshold prices for agricultural imports. Other interventions such as quantitative purchase guarantees, price guarantees, and deficiency payments for products without specific barriers to imports (vegetable oils, tobacco) are allowed to vary among member countries[1].

This system of common market regulations requires decisions on price levels and financial contributions to the European Agricultural Guidance and Guarantee Fund to be made on the supranational level in the Council of Ministers for Agriculture. From the very beginning this institutional framework has necessitated compromises between West German claims for maintaining high national price levels and the French pressure for lower prices given the higher competitiveness of French agricultural products. In the end, common prices for all goods except for cereals were fixed above the average level of all national producer prices while the politically sensitive price for cereals was set between the German and the French price.

The political economy of the CAP has a unique aspect to it. Contrary to the case of manufacturing industries, the shift of competences in agricultural policy-making to supranational institutions has not induced a corresponding diversification of pri-

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[1] For detailed studies on the CAP, see Rodemer, 1980, and the literature cited there.

vate lobby activities. The farm lobby works very effectively through national politicians, i.e. the government, and bureaucrats in the ministry for agriculture. This indirect, but nonetheless powerful representation of special interests in supranational decision-making becomes possible because all essential decisions made by the Council of Ministers require unanimity. The close relation between farmers, members of parliament and national governments is based on the high degree of organization among farmers, the proven ability of their association to swing votes not just of farmers but of major segments of the whole rural community, and the lack of any influential organization of consumer interests.

A good example of how politicians and bureaucrats further the case of the farm lobby is provided by the German Ministry for Agriculture. In 13 out of 17 price negotiation rounds (since 1969) the German representatives opposed EC Commission proposals for price changes on the grounds that they were too low. Both the West German Farmers' Association and the European Parliament always criticized Commission price proposals as too low. In 10 cases the Council subsequently raised prices by more than proposed by the Commission (Dicke et al., 1987, Table 17). As a result of successful pressure for price increases the price level for CAP products was on average about 30 per cent higher in 1984/85 than in 1968.

2. National Versus Supranational Interventions

After 25 years of experience with the CAP, the Common Market for agricultural products with common prices determined by a supranational institution has proven to be a fiction. The common prices are agreed upon in a common unit of account, the green dollar, with the objective to leave the relative competitive position of suppliers from different countries unchanged. In order to work, such a policy would require a system of fixed exchange rates among EC member countries. These exchange rates had, however, to be altered frequently. Different perceptions of the trade-off between full employment and price stability among EC member countries led to uncoordinated macro-economic policies and, in the framework of highly integrated goods and capital markets, to recurrent balance-of-payments problems. Exchange rate adjustments were unavoidable and would have deteriorated the competitive position of farmers in countries with appreciating currencies, e.g. West Germany. To prevent more competition among farmers in EC member countries, so-called monetary compensatory amounts (MCAs) were introduced, which in essence are separate exchange rates for trade with agricultural products. A system of import subsidies and export taxes in some countries and of import tariffs and export subsidies in others artificially maintain common producer prices in terms of green dollars, but if measured in actual exchange rates, producer prices have drifted further and further apart (for details, see Ritson, Tangermann, 1979).

Common producer prices have thus become more and more irrelevant

for actual agricultural prices in individual EC member countries. Higher minimum prices in West Germany discriminate against farmers in other EC countries since the multiple exchange rates in terms of MCAs prevent imports from partner countries from penetrating West German markets. Thus, the DM appreciated at even higher rates than without the border compensation. The conclusion is straightforward. The sovereignty to determine prices officially rests with EC institutions, but in reality the Council of Ministers has but a coordinating function for separate national price policies determined by national institutions.

The unabating importance of national institutions is also demonstrated by the fact that national subsidies already being paid prior to the foundation of the EC were not removed under the CAP as would have been required by the rules on competition in the Rome Treaty (Art. 40). The agricultural sector was exempted from the strict application of these rules, but the Commission proposed a code of common criteria for the compatibility of national subsidies with the common market. However, this code was not endorsed by the member countries since they considered it as too restrictive. Instead, member governments approved an alternative which envisaged a common adjustment policy with common subsidies paid from the EC budget <u>in addition</u> to national subsidy programs.

Given all these direct interventions, EC finances had to come into disarray. The financial costs of market interference, i.e. expenditures for export subsidies, storage and denaturization of products, have risen tremendously (see Dicke et al., 1987, Table

25). In 1985, they were almost ten times as high as at the end of the 1960s. Revenues from variable levies and production taxes (sugar) largely failed to balance the expenditure hike[1], so that financial contributions from member countries - basically a flat percentage of value added tax receipts - increasingly had to be used for the common fund. In 1987, two thirds of the EC budget were spent on agriculture.

3. The Future of the CAP

At the end of 1987, a re-orientation of the CAP tops the agenda of each EC ministerial meeting. Great Britain and the Netherlands vigorously demand less interventions, France an unconditional dismantling of the MCAs, and the new members Portugal and Spain an adequate share of the common budget for their farmers, while West Germany is not prepared to accept any solution which implies lower producer prices for farmers. The reasons for this renewed controversy are mostly but not entirely financial in nature. Commitments for agriculture had already reached a level in 1983 which was unsustainable without substantially increased financial contributions by each member country or a basic reform of the CAP. In addition, governments had become more sensitive with respect to their net gains from the CAP which are usually expressed in terms of net transfers, i.e. the balance between national contributions to and receipts from the CAP budget. Great Britain is a case in point with low net transfers. However, other

[1] Between 1976 and 1985, the common revenue-expenditure ratio dropped from 0.21 to 0.11.

constraints have also emerged challenging the cooperation between national farmers' associations and their governments which has worked so neatly in the past. Such additional constraints are inflationary effects of CAP financing, protests of farmers in countries with depreciating currencies who feel discriminated by negative MCAs (import subsidies and export taxes) as well as trade conflicts with the US.

Whether these and other emerging constraints will ultimately be able to alter the CAP depends on their impact on the politico-economic process of agricultural decision-making. So far, a final agreement on the future of the CAP is still pending. When the common budget was exhausted in 1983, the European Council of Heads of States merely refused to agree to higher national contributions without a CAP reform. The shape this reform is going to take is hard to predict. The available options comprise[1]

- the payment of direct income transfers;
- the extension of production quotas to products in which self-sufficiency is achieved or is going to be achieved;
- the financing of higher intervention prices and subsidies through higher producer levies, tariffs, and taxes and
- the release of new national funds by raising the percentage share of value added tax receipts without any change in price and income policies.

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[1] For a detailed analysis of options and the background of the crisis, see Gerken (1986).

What was basically implemented until 1987 was a policy package consisting of production quotas for milk, guaranteed threshold prices for cereals and wine and some other products, a gradual phasing out of the MCAs, a freeze of ECU intervention prices and production subsidies, and a mandate to negotiate higher tariffs for substitutes within the GATT. In general, there was no decision for a policy of direct income transfers, but options for both more restrictive quota and more active price policies were left open.

Both excessive interventions and the slow progress of formulating and implementing reform proposals are related to the lack of opposition against a misallocation of resources in the agricultural sector. The complexity of the CAP burdens taxpayers and consumers with high information costs if they want to assess their welfare gains or losses resulting from the CAP. These information costs may have even exceeded income losses caused by the CAP given the large numbers of taxpayers/consumers and the difficulty to evaluate its adverse effects. The income effects of raising EC prices above world market prices and the inflationary effects of widening budget deficits go largely unnoticed by taxpayers.

There is little evidence that the awareness of consumers and taxpayers concerning the consequences of protecting the agricultural sector will change in the near future. Pressure to reform the CAP seems to emerge, however, from within the ranks of farmers. An evaluation of the CAP shows (Gerken, 1986) that it has

failed to meet the legal objective to keep per capita income growth of the agricultural labour force in line with overall economic development (Art. 39 EEC Treaty). For the majority of small and medium-sized farmers income growth fell short of that of dependent workers. Interventions in agriculture have rather subsidized the least abundant factor land and have contributed to maintaining land rents. Hence, it was mainly the group of large landowners benefitting from the CAP. This elite has also dominated farmers' associations, recruited lobby representatives in parliaments, and influenced technocrats in the executive.

In recent years, small and medium-sized farmers have started to realize the uneven impact of the CAP on income of different farm sizes. Simultaneously, returns to land have also begun to fall as a result of continued surplus production and declining relative prices of agricultural products. In these circumstances, large landowners had to look for further possibilities to appease disgruntled small and medium-sized farmers and to maintain their own income position. Since the latter objective can hardly be achieved by direct income transfers, the farm lobby seems to aim at an expansion of indirect transfers through quota regulations not only for sugar and milk, but also for cereals and, perhaps, meat as well as new direct subsidies for an extensification of agricultural production for ecological reasons.

At least in West Germany, the government seems to be prepared to go along with this strategy of the farm lobby. Extensification programs have been established and additional quotas are favoured

over price adjustments in Brussels. This approach is, however, fraught with several risks (Gerken, 1986). More quotas, extensification programs, and the intention to substitute MCAs by national subsidies all put a tremendous pressure on the national budget. And, increased open subsidies for agriculture call for retaliation by other OECD countries, in particular the US. It is hard to judge if and when these constraints may lead to an essential change of agricultural policies. Over the next few years, the degree of regulations is rather likely to remain high or even to increase, but the emphasis in the two-tier system of supranational and national interventions is tilting more and more towards the national level, as was already observed in the case of declining manufacturing industries.

VI. The Role of Institutions in the Service Sector

1. Trade Protection of Services

In highly developed economies comparative advantage tends to shift from the production of goods to services. In the EC, however, service industries have not emerged as an engine of economic growth, and the trade balance of services is in deficit as the evidence presented in Chapter II.3 has shown. A major reason for this slow expansion of services are high national barriers to trade in services both within the EC and towards third countries. Unlike in the goods sector, where tariffs, quotas and other NTBs constitute clearly identifiable impediments to trade, similar impediments are difficult to pinpoint in the service sector. Rather, "grey" barriers to trade prevail which have their roots in the "designated country" principle which applies to the supply of services in all EC member countries. It stipulates that foreign as well as domestic suppliers of services have to stick to the respective standards prevailing in the country of destination. This regulation bans the import of services produced under a different set of norms.

Similar restrictions do exist for trade in goods, but they are much more important in the case of services because of the high degree of regulations governing markets for services and the substantial amount of government supervision. On the grounds of consumer protection, most EC governments have defined by law the kind of services which may be offered and closely scrutinize the

activities of suppliers through statal or para-statal agencies. These closely knit regulatory systems differ substantially among EC member countries, and so do specifications of services supplied as well as production costs. The "designated country" principle then means that there is no competition between regulatory systems of EC member countries. Imports of all those services are in effect banned which could be provided at lower costs under the regulations in the country of origin than services produced in the country of destination.

Differences among national regulations for such services as banking, insurance, tourism, telecommunication, medical care or construction have historical roots. In the first instance, they reflect attitudes of societies (and governments) towards consumer protection. Risk, health, and safety considerations are translated into minimum standards which services have to fulfill in order to prevent consumers from being harmed. The basic idea is that consumers can easily be deceived into purchasing "dangerous" goods because of high information costs. Hence, it is considered to be legitimate to limit the freedom of consumers to choose and to prohibit the supply of certain goods even if this means a real income loss. This perception of consumers' risks has also entered into the EEC Treaty. Art. 36 provides the legal framework for trade interventions if the "general interest" (i.e. health, safety, moral) would be negatively affected by free internal trade.

However, beyond these normative considerations, barriers against trade in services also are the result of interest alliances on

the national level. The interest of national bureaucrats to maintain power by controlling market access converges with the interest of national suppliers of services to fend off competition. Given the wide range of services, it is difficult to convert different national regulatory systems into price equivalents, but evidence for tourism, banking and particularly insurance (Kanthack, 1987) suggests West Germany to be a highly regulated market with high prices for services while the UK ranges at the lower end of the scale. The share of foreign insurance companies in the West German insurance market has, nonetheless, only increased from 2.7 to 3.8 per cent in 1960-1984.

2. The Legal Framework

The political and economic sensitivity towards trade in services is reflected in the EEC Treaty. Services are exempted from the general liberalization of trade among member countries (Art. 113). They are separately dealt with in Arts. 59-66 which specify different services and postulate a gradual liberalization of trade in services. Other than in the case of Art. 113, Arts. 59-66 do not commit member countries to free trade, but envisage a complicated stepwise procedure under the auspices of the EC Commission with built-in escape clauses[1] (for details, see Hindley, 1987). No steps have been taken so far, however. Since more liberal trade in services would require the modification or re-

[1] An exception is the transport sector. Arts. 74-84 explicitly postulate a harmonization of national standards, but a common policy has not been accomplished, yet.

moval of national laws the Council of Ministers would have to co-operate with the Commission to establish an EC competence and to enact common rules for the reduction of indirect barriers to trade. The second-best solution could be a harmonization of national regulations as an alternative to both the "designated country" principle banning trade and the "country of origin" principle creating trade in services. The Commission has tried for years to negotiate such a harmonization or at least common minimum standards, but was not able to overcome the reluctance of the Council to reach an agreement.

The present situation is characterized by national governments anxiously protecting their sovereignty and a Commission seeking to enlarge its influence by achieving a true legal competence for EC trade in services. It is no surprise, then, that the assessment of the Council and the Commission on obligations of member countries with respect to a liberalization of the service sector diverges. Therefore, the European Court has - in accordance with Art. 169 - acquired an important mediating function between national and supranational institutions. A key question is whether consumer protection "formulated as a matter of general interest" (Art. 36) can be overridden by the principle of free physical access to markets, even if national rules for consumer protection have historically developed along different lines. The European Court had to deal with several cases concerning intra-EC trade in specific services brought to court by the Commission against governments of individual member countries. The most prominent one was the "Cassis de Dijon" case in which the Court had ruled

in 1979 that imports from other EC countries cannot be restricted on the grounds of different national regulations if the products concerned "have been lawfully produced and marketed in one of the Member States" (cited in Pelkmans, 1986, p. 359). This court ruling refers to trade in a specific product, namely the liqueur "Cassis de Dijon", but the Commission considered the verdict as also applicable to trade in services (COM (85) 310, 1985, p. 27). The Commission argued that the court ruling would allow free trade in services without harmonizing national regulations (and hence, competition between regulatory systems) provided consumers will be informed about the implications of different regulations in the countries of origin for the type of service they want to purchase. The Council has, however, opposed this interpretation. Governments of member countries continue to consider free trade in services as potentially dangerous for consumers since costs of misinformation may be much higher in the case of services compared to goods, and any damage as the result of free trade could not be remedied unilaterally, but would require the co-operation of other member countries (Hindley, 1987, pp. 484-485). For these reasons, the Council demands agreement on minimum standards before a common market for services can be permitted. Given the substantial differences among national regulatory systems and vested national interests, agreement on such minimum standards is not easily achieved, and it is hardly surprising that discussions between the Commission and the Council have not yielded any results so far.

In the meantime, decision-making is shifted from the Council to

the Court but this does not open bright perspectives for freer trade in services. Court rulings refer to specific cases only and are restricted to a legal interpretation of the EEC Treaty. The Court cannot establish new general rules and has to accept invocations of Art. 36.

3. Prospects for Trade in Services

Although little has been achieved in legal terms to deregulate trade and production of services, self-interest of market participants has in practice contributed to erode the "designated country" principle. Entrepreneurs themselves have been most ingenious in finding loopholes in regulations, in shifting business to extra-EC locations with less regulations (banking), and in introducing new types of services (financial intermediation). If high rents accrue from regulations in one country, these are an incentive for suppliers from other countries to overcome artificial and natural (language) barriers to trade by moving production across borders and establishing shadow markets. The Common Market principles of non-discrimination between residents from different EC member countries and freedom of establishment are instrumental in these circumventions of legal rules. An example are Dutch dentists offering their services across the border in the Rhein-Ruhr area of West Germany.

Consumers are another interest group which erodes many national regulations, not by their organizational power but merely by individual behaviour. Tourism and aviation are the most important

areas in which price differentials between services supplied in different EC member countries can be easily and relatively risklessly exploited. It is not by chance that air transport is one of the service sectors in the EC where market forces have made many regulations economically meaningless.

Finally, non-EC governments and international commitments have enforced some de facto deregulation of trade in services through the threat of retaliation. External pressure on the EC has acquired a new dimension with the new GATT Round. In the preparatory negotiations and the Ministerial Meeting in Punta del Este in September 1986, the EC committed herself to discuss a liberalization of trade in services. With the GATT Round progressing and continuing EC-internal delays in deregulating services, the EC may face a situation in which multilateral liberalization in some service sectors goes beyond what has been achieved within the EC so far (Horn, 1987, p. 491). This would render EC decisions redundant and therefore constitutes an incentive to proceed internally in order to be prepared for even further-reaching claims for liberalization by the US or other OECD countries with substantial power to retaliate. These prospects may induce the alliance of national bureaucrats and national suppliers of services (often organized in guilds) to back off and to rely more on the still powerful natural barriers to trade such as high costs of information concerning prices and specifications of services as well as on language and inertia. Since consumption expenditure is shifting from goods to services, many suppliers of services will also recognize that their opportunity costs of blocking

market access are going to increase, and that import liberalization is a quid-pro-quo for export liberalization. All in all, the future seems to hold some promises for expanding trade in services, both internally and across EC boundaries.

VII. Policies and Institutions in Labour Markets

1. The Policy Framework and Its Impact on Labour Costs

The Treaty of Rome does not only envisage a common product market among EC member countries but also a common labour market. Arts. 48-66 of the EEC Treaty provide for freedom of movement, rights of establishment and freedom to provide services within the Community. In addition, there is much secondary legislation establishing these principles in greater detail and specifying their application in different employment sectors. There are directions regulating redundancy provisions, equal treatment for men and women, safety at work and other work conditions (for details, see Employment Regulations, 1986). Legal exceptions from the principle of free movement of labour have, however, been made for new member countries such as Greece, Spain and Portugal during a transition period of about 7 years (EC, Bulletin, 1985, pp. 8-9).

Over and beyond the basic principles established in the Treaty of Rome labour market problems did not attract much attention at the EC level. Trade unions, employers, various other interest groups as well as the Commission and the Council meet in two committees, the Economic and Social Committee (ESC) and the Standing Committee on Employment (SCE), to consult on the conceptual harmonization of labour codes and the formulation of a Community employment policy, but these efforts have hardly borne fruit to date (Barnouin, 1986, pp. 79ff.). The European Social Fund (ESF) already stipulated by the Treaty of Rome has remained the only EC

institution to deal specifically with employment problems. The ESF was set up to compensate persons whose employment was threatened by any structural change that the establishment of the Common Market might generate. The Fund has, however, played at most a marginal role as a social policy instrument (Barnouin, 1986, pp. 84-85). Its scope was restricted to aid in re-training and re-settling of workers who had lost their employment through structural industrial change, and its financial resources have remained inadequate. In 1983, about 1.7 billion ECU or less than 1 per cent of the Community's total budget were dispersed for ESF activities when the European Trade Union Confederation (ETUC) estimated the financial requirements to be in the vicinity of 22 billion ECU or 10 per cent of the total budget (Barnouin, 1986, p. 85).

Despite the attempt to create a common EC labour market migration of labour within the EC has rather remained the exception than become a rule. There was a considerable inflow of guestworkers which peaked in the early 1970s but these migrant workers consisted mainly of unskilled and semi-skilled manual workers from Mediterranean countries outside the EC such as Spain, Northern Africa and Turkey (Böhning, 1976). Since 1975, the net inflow has tapered off largely as a result of additional barriers to immigration erected at the national level which either restrict entry or give incentives to a repatriation of migrant labour after some years of working abroad. In 1982, the share of foreign labour in the total work force accounted for 3.7 per cent in the Netherlands, 6.6 per cent in France, 8.2 per cent in Belgium, and 9.2

per cent in West Germany (OECD, 1985, Table 20). It has remained an open question whether the inflow of these guestworkers has actually dampened wage increases and, thus, contributed to a delayed structural adjustment in EC countries.

Labour migration within the EC is impeded by language barriers and differences of life styles, but even more so by national labour market regulations effectively eroding the principle of freedom of movement. Such regulations include specific qualification and establishment requirements, non-recognition of diplomas or degrees obtained in other EC countries, and the impossibility to transfer accrued welfare benefits from one country to another. Costs of migration have, thus, been increased to a prohibitive level and hence, it is not surprising that migration of labour across EC borders is virtually non-existent, in particular in the professions (see the data provided in EC Bulletin, 1986, Tabs. 1-4). There is no competition between national labour codes in the EC, and imbalances that might occur in labour markets cannot be corrected by the free movement of labour. Consequently, wage levels and wage differentials among sectors and regions are entirely determined by national labour legislation and national bargaining between employers and trade unions.

Labour regulations in EC member countries concern the following broad categories: pay systems, "hiring and firing rules", income maintenance at working age, and social services. In all these categories regulations differ substantially among countries (Employment Regulations, 1986), but as a common denominator they

have introduced more rigidity into European labour markets than was observed in Japan or the US (see the excellent survey by Emerson, 1986). The inflexibility of labour markets towards the changing national and international economic environment in the 1970s and 1980s has caused adjustment through variations of the quantity of employment as evidenced by the rise in unemployment and the decline of participation rates shown in Chapter II.4. Neither Japan nor the US have recorded similar employment problems in this period of time.

Concerning the pay system, important features are the centralization of wage bargaining, the extent of union power and the coverage of minimum wage legislation which all would influence inter-industry wage differentials. The US labour markets are governed by the least regulatory system compared to Japan and Europe. Wage bargaining is extremely decentralized with 195,000 different bargaining agreements which nonetheless cover only 25 per cent of the labour force, and minimum wages do not have much influence on actual wages (Emerson, 1986, pp. 20ff.). Japanese and European labour market regulations have in common a much higher degree of centralized wage bargaining and more binding minimum wages (see also Bruno, Sachs, 1985). In Europe, the latter are set by collective bargaining either at the national or the industry level and have the force of law, or there are statuary national minimum wages. The Japanese system differs in two important respects. First, about 25 per cent of a worker's pay consists of bonus payments which are more variable than base wages (Weitzmann, 1985) and, secondly, minimum wages differ among regions (prefec-

tures).

The impact of all these regulations on labour market flexibility can be gauged from two sets of data published by the OECD (1985, pp. 78 and 84f.). The first concerns wage differentials between smaller and larger firms. It turns out that in the US wages are much lower in small firms (with 10-99 employees) relative to large firms (with over 500 employees) than in Japan or Europe. The ratio of small to large firm wages amounts to 57 per cent in the US, 77 per cent in Japan, 83 per cent in France, 85 per cent in Italy, 90 per cent in Germany, and 93 per cent in Denmark. The second set of data provides information on inter-industry wage differentials measured by coefficients of variation. In the early 1980s, this coefficient (standard deviation as percentage of the mean) was 23 per cent in the US, but ranged between 8 to 11 per cent in France, Germany, Italy, the Netherlands, and Denmark. Surprisingly, Japan reveals even wider inter-industry pay differentials than the US (with a coefficient of 26 per cent). This observation proves that workers' protection and flexibility of pay scales are not contradictory goals per se.

Another important aspect of workers' protection and hence, labour market regulation are hiring and firing rules. They involve rules of recruitment (e.g., privileges for disadvantaged minorities), rules for individual dismissals, rules for collective redundancies and lay-offs, as well as rules for temporary, part-time and fixed-term employment. Excessive employment protection can be expected to dampen growth of employment through adding a semi-

fixed element to the cost of labour and encouraging the substitution of capital for labour.

The differences among regulations applied in the US, Japan and Europe are fundamental (for details, see Emerson, 1987). In the US, there is hardly any federal or state law regulating hiring and firing; these issues are rather left to the free choice of the market. Both Japan and Europe have a complex set of legal and customary provisions assuring a great preference for permanent employment and security of tenure. However, Japanese enterprises enjoy more flexibility than their competitors in Europe since at least a minority of positions does not benefit from the regular permanent employment regime, and small firms are able to adjust rather freely the size of their work force because they employ a large fraction of temporary workers. In the EC, almost all countries have severe regulations protecting employment many of which were introduced in the early 1970s. It appears reasonable to assume that structural change in the EC was considerably impeded by restrictions on dismissals since they were established at the beginning of a long period of recession and slow economic growth when the probability of having excess manpower in the average firm increased. As a result, employment growth has been weak in the EC, and labour-saving capital deepening has been evident (Mortensen, 1984).

The social considerations leading to all-encompassing rules for employment protection in the EC have also inspired income maintenance policies which include unemployment compensation, sickness

benefits, invalidity and disability pensions, early retirement schemes as well as family and maternity benefits. These policies differ among EC countries, but on average eligibility criteria are much wider in the EC than in the US. Although it is difficult to assess the economic impact of income maintenance policies, two consequences seem to be firmly established (Emerson, 1987, pp. 32-40). One is the considerable burden of these policies for public budgets which amounts to around 10 per cent of GDP in most countries. The other concerns higher rates of absenteeism and disabilities observed in the EC compared to the US and Japan. All in all, transfer payments translate into an addition to wage costs in the order of 20 per cent which negatively affects the international competitiveness of EC firms and frequently serves as an argument for more protection. An evaluation of basic social services such as health care, education and pension schemes yields a similar conclusion: expenditures are much higher in the EC than elsewhere, and respective regulations introduce an additional measure of rigidity into EC labour markets.

Concerning the future path of structural adjustment in EC countries the key question is whether labour market regulations in general can be modified in such a way as to allow more inter-regional, inter-industry and inter-firm size differentiation of labour costs. It is not whether socially motivated labour market policies should be abolished entirely. To provide an at least tentative answer to this question calls for an assessment of the major political forces influencing the future course of labour market policies.

2. The Political Economy of EC Labour Markets

From a traditional perspective trade unions are often considered to be the most important pressure group responsible for rigidity in wage levels and over-regulation of labour markets. If this were the case, trade union power as expressed by membership and effectiveness in industrial disputes would be the key variable for explaining the differences among regulatory systems within the EC and elsewhere. Data on labour relations presented in Table 7 lend some support to this hypothesis, at least as far as a comparison between the EC and other major industrialized countries is concerned. In most EC countries trade unions membership is much higher than in either the US or Japan which seems to suggest that EC trade unions can wield more political power in terms of their influence on voters. They are not only able to bargain harder with employers' associations but also to have a say with respect to incomes and welfare policies applied by the government. Membership seems to be a more important aspect of union power than militancy. When militancy is measured by working days lost in industrial disputes, US trade unions rank high compared to EC countries (Table 7), although their impact on labour market regulations has remained feeble. Within EC countries, an association between militancy and political influence cannot be observed either. The average number of working days lost in industrial disputes rather indicates a negative correlation between militancy and degree of labour market regulation, at least for the larger countries. Germany and the Netherlands have the least militant unions but a relatively high degree of regulation, while

Table 7 - Labour Relations in EC Member Countries, 1975-1984

Country	Trade union membership density (in per cent)				Industrial disputes									
					Working days lost (000s)					Working days lost (per 1000 employees)				
	1975	1980	Latest year available		1975	1980	Latest year available		Annual average	1975	1980	Latest year available		Annual average
Belgium	75.0	n.a.	84.0	(1981)	610	222	n.a.		656[a]	196	71	n.a.		212[a]
Denmark	74.0	89.0	82.0	(1984)	100	187	132	(1984)	199[b]	54	93	65	(1984)	101[b]
France	23.0	28.0	n.a.		3869	1679	2675	(1984)	2807[c]	234	98	178	(1984)	168[c]
West Germany	41.0	42.0	43.0	(1984)	69	128	5618	(1984)	1125[b]	3	6	255	(1984)	51[b]
Greece	n.a.	n.a.	n.a.		788[d]	2907	1431	(1982)	1408[e]	n.a.	1743	835	(1982)	922[e]
Ireland	40.4	n.a.	42.4	(1982)	296	412	336	(1984)	558[b]	390	480	468	(1984)	685[b]
Italy	n.a.	39.5	38.7	(1981)	20603	12626	14393[f]	(1983)	15311[c]	1645	921	975	(1983)	1147[c]
Netherlands	45.0	45.0	43.0	(1983)	7	55	115	(1983)	99[b]	2	14	27	(1983)	27[b]
Portugal	n.a.	n.a.	n.a.		310[g]	533	651	(1983)	532[h]	128[g]	136	237	(1983)	166[h]
Spain	n.a.	n.a.	n.a.		1815	6177	4229	(1984)	8428[b]	205	549	569	(1984)	818[b]
United Kingdom	49.5	53.1	53.5	(1983)	6012	11964	27135	(1984)	11075[b]	269	531	1145	(1984)	489[b]
For comparison														
Japan	35.0	31.0	30.0	(1983)	8016	1001	507	(1983)	1964[i]	222	25	12	(1983)	53[i]
United States	29.0	25.0	n.a.		31237	33289	24730	(1981)	35334[j]	410	376	251	(1981)	424[j]

a = 1974-80; b = 1975-84; c = 1974-83; d = 1976; e = 1976-82; f = ILO estimate; g = 1977; h = 1977, 1979-83; i = 1975-83; j = 1974-81

Source: Walsh and King (1986); own calculations.

the UK labour markets are less regulated despite of union militancy.

Union membership alone can, however, not be regarded as a sufficient condition for labour market rigidities either. Denmark, Germany and France have similarly restrictive systems of regulations despite substantial differences in their shares of organized labour, and high membership shares in the UK have not prevented the government from deregulating labour markets. What seems to matter with respect to rigidities of labour markets is rather the degree of collusion between interest groups and governments which is referred to as "neo-corporatism". Strong corporatist structures allow an ex-ante coordination between trade unions, employers' associations and the government based on a pervasive ideology of social partnership, and they rely on the cooperative efforts of relatively centralized institutions representing business, trade unions and the state in key economic and social policies. This tripartite cooperation may bring benefits in terms of coherence of income bargaining with macroeconomic policy, achievement of harmony rather than conflict in industrial relations, and amenability of labour to the dissemination of technical progress on the shop-floor. It may cause economic costs, however, if the ideology of social partnership becomes overriding and issues such as productivity growth and macroeconomic stability are neglected.

Criteria favouring corporatism are considered to be (i) the extent of trade union membership, and the unity or cohesiveness of

leadership of the trade unions assured by its peak organisations, and the ability of the peak organisations to deliver shop-floor adherence to centrally negotiated deals, (ii) similar qualities of membership, unity and leadership among employers' organisations, (iii) the importance of works councils or other cooperative bodies bringing workers and management together in the enterprise, and (iv) the importance of the range of policy issues over which effective consultations are carried out on a tripartite basis between government, labour and employers. A rank order of the strength of corporatism, based on a weighting of indicators representing the foregoing criteria, has been suggested by Bruno and Sachs (1985):

1. Austria
2. Germany
3. Netherlands
4. Norway
5. Sweden
6. Denmark
7. Switzerland
8. Finland
9. Japan
10. Belgium
11. Italy
12. France
13. United Kingdom
14. United States

The list is headed by Austria, Germany, the Netherlands and the small norther European countries. Japan follows, receiving high points for concertation of labour and employers at the enterprise level, but scoring less high on tripartism on public policy issues. Italy and France have some corporatist traditions and institutions, but in both cases the ideological splits and militancy of trade unions, and their limited representativity bring

down their corporatist score. The UK score is brought down by a highly fragmented and competitive craft structure of the trade union movement, coupled with highly conflictual tendencies in industrial relations. Finally, the US comes lowest in the corporatist ranking because of low membership and weak central leadership roles of labour and employers' organisations.

This rank ordering is an indicator of the capacity of corporatist structures to deliver benefits or threaten costs to the governments as they execute policies which may be more or less welcome to the major interest groups. It is difficult to assess, though, whether there have been net economic benefits or costs of these structures. Simply judging by relative labour market performance, the uncorporatist US and Japan seem to have done better than the most corporatist EC countries such as, e.g., Germany and the Netherlands which have encountered high rates of unemployment in the late 1970s and 1980s. This observation and the increasing rigidity of wage levels lead some observers to believe that neo-corporatism has not necessarily been beneficial for the European economies (see, e.g., Heitger, 1987).

The important point to note in this context is the fact that co-operation between workers, employers and politicians has not abated despite unsatisfactory labour market developments in the EC. The corporatist structures have also prevented supra-national institutions from assuming responsibility for labour market policies. The president of the EC Commission, Jacques Delors, has proposed to introduce common EC pay agreements, but both trade

unions and employers do not find the time ripe for a harmonization of EC labour markets (FAZ, 8 September, 1987). Concerning the perspectives for the next decade, it seems safe to assume that corporatist structures will continue to determine labour market developments. This means in particular continued lack of labour mobility within the EC, high rates of unemployment which may decline slightly as population shrinks, little inter-industry or inter-regional wage differentiation, and high non-wage labour costs. All these factors will not enhance but retard inter-industrial and inter-regional adjustment processes.

VIII. Medium-Term Perspectives for Institutional Change in the EC and in EC Member Countries

The above analysis of policy interventions into the functioning of EC markets has unfolded a quite heterogeneous bundle of regulatory systems reflecting the economic interests of the major actors in the respective markets. Some common features of institutional intervention stand out, though. In all markets, except of services, institutional intervention has increased over the last two decades with the intention to slow down or to facilitate structural adjustment. More interventions in favour of sunset industries, agriculture and employment protection have - in line with Hillman's (1982) reasoning - neither been able to prevent an economic decline of ailing activities nor an increase of unemployment. The economic costs of these interventions had to be borne by taxpayers and consumers, by sunrise industries including services, and by suppliers in particular from developing countries whose access to EC markets remained severely restricted.

Sunrise industries did not only suffer indirectly through cost disadvantages accruing from protection of sunset industries and labour, but also from the emergence of technology policies which intervened in the direction of research and product innovation. Some degree of deregulation has, however, been taking place in services which initially was an almost completely regulated activity. This more factual than legal deregulation has so far hardly contributed to the international competitiveness of EC service industries, but it has improved access of non-EC suppli-

ers to EC markets as witnessed by the continuously negative balance of trade in services.

These findings indicate that policy interventions were not part of an all-encompassing adjustment strategy applied by EC institutions but rather the outcome of bargaining among pressure groups. For this reason, there was no uniform pattern of institutional change with regard to the major economic sectors. National politicians have been competing with supranational institutions for resources and competences, while private interest groups were operating both at the national and the supranational level depending on the potential "profitability" of lobbying activities. In sunset industries and agriculture, important legal competences such as common trade and price policies rest with EC institutions; yet, a permissive application of escape clauses, an approval of national subsidization schemes as well as the introduction of new non-tariff trade barriers have led to a de facto renationalization of policy intervention in these sectors. National politicians do not seem to be prepared to give up their power to intervene when regional or sectoral income imbalances or employment issues are directly concerned as Pelkmans (1986) had suggested. Much in the same vein, attempts to create a common EC labour market have not made much progress.

Support for declining industries has made increasingly heavy claims on national budgets so that it became unavoidable to set priorities when European technological co-operation emerged as a new topic on the agenda. Financial support for both sunset and

sunrise activities overtaxed the capacity of national governments to provide the required budget appropriations and hence, technology policies have gradually been shifted from the national to the supranational EC level. Aside from budget constraints, such a transfer of competences was facilitated by the fact that the link between technology policies and the well-being of the general public is less direct or at least less visible than in the case of support for sunset industries.

For entirely different reasons, a tendency towards a supranational institutional framework was also observed in the case of services. The highly regulatory national policies had to be watered down somewhat on account of common interests of consumers and producers to improve market access and because of retaliatory threats from non-EC countries. External pressure on the EC has acquired a new dimension with the new GATT Round which has opened the perspective of a truly international institutional framework for trade in services.

Turning from the past and present to the future, further institutional change is hard to predict since a number of conflicting forces will remain at work. First, EC member countries have agreed to establish a "Common Internal Market" until 1992. This is a political decision which would require an enormous amount of harmonization among widely differing national standards and norms, common rules for national subsidy schemes, and a dismantling of non-tariff trade barriers. Observers tend to agree that the necessary negotiations and legal procedures will not be com-

pleted until the envisaged date, in particular since the Southern enlargement of the EC has complicated the matter substantially. Nonetheless, there are many proponents of deregulating trade within the EC who expect a common market to create new trade opportunities and to enforce a harmonization of economic policy-making among EC member countries. They refer to the experience with the European Monetary Union which has forced more monetary restraint upon EC governments (Scheide, Sinn, 1987, pp. 21-23) and contributed to price equalization within the EC (Langhammer, 1987). Whatever the impact on economic policies will be, a common market is likely to be achieved only at the expense of more discrimination against suppliers from non-EC countries.

Secondly, the EC budget is in a financial crunch which has to be resolved before a common market can be established. In the past disputes over financial matters have been settled by increasing contributions to the EC and simultaneously shifting some cost-intensive regulations back to the national level. As it looks now, both remedies will again be applied to solve the present financial crisis. Re-nationalization of sector policies for e.g. agriculture or steel runs, however, counter to harmonization and deregulation envisaged to establish a common market. The experience particularly in agriculture shows that national support schemes differ widely among EC member countries and can be sustained only when intra-EC trade is severely restricted. The EC steel cartel represents the result of a similar basic situation. Therefore, re-nationalization of EC competences and the establishment of a common market are mutually incompatible.

And finally, there is an increasing pressure on EC institutions and member governments to open EC markets to non-EC suppliers which is not likely to abate. Mainly the US, but also some highly indebted NICs demand a reduction of EC trade barriers in agriculture and less subsidies for sunset industries. The US is also pushing the issue of free trade in services. Most of these topics are on the agenda of the current GATT Round, and the US appears to be determined to win some concessions from the EC.

The ultimate outcome of this struggle between countervailing political and economic forces is hard to predict with some accuracy. The reading on the wall is, however, that institutional intervention in the functioning of EC markets is rather going to increase than to be diminished over the next 10 or so years. These interventions will continue to aim at slowing down structural adjustment with the underlying intention to preserve existing jobs. In addition, they will attempt to enhance technological progress based on a concept of strategic industrial policies which is inspired by a fundamental misunderstanding of the Japanese industrialization process. More interventions will in any case mean slower growth of imports from non-EC countries, but may have different implications for intra-EC trade. In agriculture and such sunset industries as steel and shipbuilding the signs clearly point at a re-nationalization of interventions with the necessary consequence of less extra- and intra-EC trade. Trade in textiles and clothing is subject to international negotiations between sellers and buyers. Little change is expected for these industries since the EC cannot act independently with-

out fear of retaliation. Concerning sunrise industries, budget constraints and politico-economic considerations will contribute to enlarge supranational competences at the EC level and hence, the establishment of a common market is likely to make headway in this area, albeit at the expense of non-EC suppliers. The only exception from this gloomy picture could develop in the area of services. The collusion of interests among consumers, producers and non-EC governments suggests at least some degree of trade liberalization in services.

If these institutional changes are going to take place, the future macro-economic performance of EC countries will hardly improve. Protection of ailing economic activities is going to cause an even greater vast of resources without ultimately preventing an increase of unemployment. A limited common market cannot generate a new export boom and more economic growth than 60-70 per cent of industrial exports of EC member countries already go to other European destinations. Incentives given by technology policies are likely to encourage competition for public funds but do not necessarily promote technological progress in the required direction. And finally, expansion of service industries will be severely hampered by labour market rigidities which may even increase as a result of ill-conceived policies to fight unemployment. All these factors combined could contribute to a protracted period of slow economic growth in EC countries which in turn means slow overall growth of import demand. The main chance for non-EC suppliers to increase exports to the EC will, then, be to increase market penetration by outcompeting domestic producers.

IX. Prospects for ASEAN-EC Economic Relations

The institutional barriers to trade discussed in the previous chapters may have dampened the expansion of ASEAN exports to the EC, but they have by far not succeeded in preventing ASEAN suppliers from capturing market shares in EC member countries comparable to those in other industrialized countries. Table 8 shows ASEAN shares (market penetration ratios) in EC, North American and Japanese markets of manufactured products for 1970 and 1983, the latest year for which the required data are available. In all industrialized regions/countries covered by Table 8 the ASEAN market shares in total manufacturing have remained small until 1983; there has, however, been a substantial increase of these shares in all regional markets reflecting the industrialization and export efforts of all ASEAN countries in the 1970s which suggests that the EC could ultimately not protect her markets to a higher degree than, e.g., the US.

A comparison of market shares by product categories reveals substantial differences in the division of labour between ASEAN countries and individual industrialized markets. Both in the EC and North America ASEAN exporters have made inroads into markets for labour-intensive resource-based products as well as machinery. The latter was rather prominent in the case of North America which indicates that ASEAN-US trade relations are characterized by an emphasis on intra-industry division of labour while inter-industry division of labour dominated in the EC case. Trade with Japan narrowly focuses on raw materials such as oil and metals

Table 8 - Market Penetration Ratios[a] for Imports from ASEAN Countries in Selected Industrialized Countries, 1970 and 1983, in per cent

Product category	EC	US/ Canada	Japan	EC	US/ Canada	Japan
		1970			1983	
Food, beverages & tobacco	0.05	0.20	0.17	0.20	0.19	0.09
Textiles	0.01	0.04	0.03	0.30	0.17	0.23
Clothing	0.01	0.20	0.03	1.03	1.43	0.22
Wood products, paper & printing	0.13	0.08	0.13	0.73	0.22	0.24
Rubber	0.01	0.01	0	0.12	0.04	0.08
Chemicals	0.09	0.15	0.10	0.37	0.20	0.28
Petroleum & coal products	0.04	0	2.32	0	0.21	2.75
Non-metallic mineral products	0	0	0	0.03	0.03	0.01
Ferrous & non-ferrous metals	0.19	0.17	0.49	0.18	0.11	0.49
Transport equipment	0	0	0.01	0.04	0.02	0.01
Machinery & other manufactured products	0.01	0.02	0.01	0.59	1.11	0.16
Total manufactures	0.06	0.08	0.18	0.32	0.38	0.46

[a]Share of imports in apparent consumption.

Sources: OECD, Foreign Trade by Commodities 1970 and 1983, Series C, Paris 1972 and 1985. - OECD Microtables : Annual Foreign Trade Statistics by Commodities 1983, Series C. - UNCTAD, Handbook of International Trade and Development Statistics 1979 and 1986, New York 1980 and 1987. - Own calculations.

while ASEAN market shares in other traditional and in non-traditional exports have remained insignificant.

Trade patterns reflect both the efforts of ASEAN exporters to gain access to markets and the response of competing firms in industrialized countries. In the 1970s, US as well as Japanese companies have established production capacities in ASEAN countries to make use of the local availability of raw materials and cheap qualified labour (for details, see Hiemenz, Langhammer et al., 1987). The thrust of US foreign direct investment was to shift labour-intensive lines of production (particularly in electronics) to ASEAN countries and to re-import intermediate products. Foreign subsidiaries have, thus, served as a door-opener to US markets which explains the focus on an intra-industry division of labour. Much in the same way has Japanese direct investment facilitated raw materials exports to Japan. A similar engagement of EC companies in the ASEAN region has not been taking place in the past for reasons discussed elsewhere (Hiemenz, Langhammer et al., 1987, Chapter VI). Therefore, exports to the EC were much more dependent on own efforts of ASEAN suppliers and their co-operation with EC importers and retailers, which is reflected in more inter-industry specialization than in the case of the US.

A final observation with respect to ASEAN-EC trade relations concerns trade in services for which detailed data are not available. It is, nonetheless, a well-known fact that service exports to the EC have increased tremendously over the last 20 years, in particular in categories such as air transport and tourism. All

ASEAN countries have improved the international competitiveness of their airlines and captured substantial market shares in the EC-ASEAN air traffic with both passengers and cargo[1]. Some countries such as Indonesia, Singapore and Thailand have furthermore become attractive destinations for tourists from EC countries. Beyond such activities, Singapore has developed into an international financial center with increasing importance also for customers in the EC.

Future perspectives for ASEAN exports to the EC hinge on three major determinants: institutional barriers to market access, the attitude of EC firms towards ASEAN countries, and the results of present GATT negotiations. It was argued in the previous chapter with respect to industrial products that a relaxation of EC trade protectionism is not in the making. Efforts to establish a true common market in the EC may rather enhance protectionist practices against non-EC suppliers. Given the Generalized System of Preferences (GSP), what matters most for ASEAN countries are the MFA and non-tariff trade barriers mostly applied by individual EC member countries. Under the threat of an increasingly inward-oriented industrial policy in the EC, ASEAN countries have primarily two options to sustain their export expansion to European markets: product differentiation and political pressure in favour of deregulation.

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[1] In 1986, Asian airlines associated with IATA have had a 39 per cent share of European air traffic with the Far East according to IATA statistics.

Product differentiation means to shift the export mix gradually towards more intra-industry specialization with the EC as it was observed between the ASEAN region and the US. Intra-industry specialization is less prone to protectionist measures than inter-industry specialization which may directly cause unemployment and enforce regional imbalances.

Political pressure can help to stem the tide of protectionist sentiments in the EC, if applied commonly by all ASEAN countries. The ASEAN-EC Co-operation Agreement has already been successful in that ASEAN countries were granted a special quote regulation under the MFA (for details, see Langhammer, 1985). This agreement could be further exploited to improve the GSP (e.g. with respect to less binding rules of origin) and to liberalize the MFA. Furthermore, the ASEAN group should - perhaps together with the East Asian countries - be able to influence GATT negotiations on trade in services, a point which will be elaborated below.

More intra-industry specialization between ASEAN and the EC could be facilitated if EC firms would directly engage in production activities in ASEAN countries. This region has played only a marginal role as destination for EC foreign direct investment, but there are indications that the attitude of EC firms towards investing in ASEAN countries is changing slowly. Rapid economic growth and an increasing division of labour in the Asia-Pacific region compared to economic decline and disintegration in Latin America and Africa, the traditional destination of EC foreign investment in developing countries, have finally caught the at-

tention of both managers and politicians in the EC. Whether the growing interest in Asia in general will finally generate more EC investment in ASEAN countries will depend on the attractiveness of ASEAN vis-à-vis other locations in the region. ASEAN governments can contribute to improve this attractiveness by further liberalizing investment regulations and removing red tape, but even more so by eliminating the still substantial inward biases in their own trade and industrialization policies (for details, see Naya, 1987). The bad example of the EC should not be used as an excuse to repeat the same mistakes in ASEAN countries which cause high economic costs in terms of potential income growth and employment opportunities foregone.

Internal budget constraints and external pressure in the Uruguay Round may lead to some reduction of agricultural protectionism in the EC which could be exploited by ASEAN suppliers[1]. The main hope for the GATT negotiations is, however, related to a substantial liberalization of trade in services. The EC Commission has already put pressure on national governments to deregulate air traffic and is preparing suggestions for better access to banking (FAZ, 13 January, 1988, p. 13). The latter also reflects external pressure from the US to open up the EC market to foreign banks, much in the same way Japan has begun to liberalize her capital market. Pressure on the EC could be greatly increased if developing countries and in particular Asian developing countries would

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[1] As members of the so-called Cairns Group ASEAN countries have already made proposals for liberalizing trade in agricultural products under GATT rules and disciplines.

join the US in demanding freer trade in services. The negotiating stance of Asian developing countries would become even stronger if they were prepared to offer reciprocal concessions in return for better access to EC markets for services, i.e. if they would offer better access to their own markets in exchange for a liberalization of EC markets.

Lower barriers to trade in services holds great promises for ASEAN services' exports. A deregulation of air traffic offers chances to the already very competitive ASEAN airlines to conquer additional markets shares in the EC-Asia business, to enter into the intra-EC market, and to promote tourism in ASEAN countries. In addition to air transport and tourism, there are a number of other service activities in ASEAN countries which will benefit from a deregulation of trade in services with the EC (for details, see Praet, 1982). As far as the meagre data base goes, indications are that better access to national capital markets in EC member countries and participation in information as well as communication services can improve EC-ASEAN economic relations.

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