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Article — Digitized Version

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Intereconomics

Suggested Citation: Bayliss, Brian (1976) : The United Kingdom and the future of the EC, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 11, Iss. 11, pp. 299-301, <https://doi.org/10.1007/BF02929746>

This Version is available at:

<https://hdl.handle.net/10419/139422>

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The United Kingdom and the Future of the EC

by Professor Dr Brian Bayliss, Bath *

The crises and recession which have hit the Western industrialised countries since the end of 1973 have brought in their wake a chain of economic events which have led many to question whether the European Community can survive. The economic benefits to be derived from an economic union will only be forthcoming if the economic development of the countries comprising such a union is similar. If the union is extended into an economic and monetary union, then harmonisation and stabilisation of both economic and monetary developments in the member countries is required. It is the divergence of economic and monetary developments in the member countries of the EC following the Middle East crisis of 1973 which has led to doubts about the future of the Community.

Divergent Economic Trends

The quintupling of posted oil prices and the general rise in the world price of primary products created at the beginning of 1974 enormous balance of payments problems for the EC member countries, an acceleration of an already rising rate of inflation, and a boost to unemployment levels already affected by a general downturn in economic activity. However, although 1974 saw serious divisions amongst the member states in their policies towards securing oil supplies, wide divergences in the rates of inflation, and major differences of opinion in relation to the monetary and economic policies to be pursued, the situation, with the exception of the United Kingdom, improved remarkably during 1975. By mid 1975 industrial

production had begun to rise in a number of countries, and inflation for the twelve months up to the end of 1975 had been reduced to single or near single figures in the original Six and Denmark.

In the United Kingdom, however, 1974 had seen a complete relaxing of incomes policy and an expansion of public expenditure. By the Summer of 1975 inflation was running at an annual rate equivalent of well over 40 p.c., and despite the introduction of an incomes policy in the Autumn of 1975 the rate of inflation for the twelve months up to the end of 1975 was 25 p.c. It was not until mid 1976 that consideration was given to calling a halt to the expansion of public expenditure. This delay in taking deflationary measures meant for the present a narrowing of the differences in production between the United Kingdom and the other members of the Community; for the future, however, it means that the United Kingdom will continue to fall further behind its partners.

The entry of the United Kingdom into the European Communities on January 1, 1973, was considered by many to be the means by which the impasse in which the Six found themselves at that time could be overcome. Yet the United Kingdom's economic performance relative to the other member countries had been declining since the 1950s, and the last four years have seen little change in the relative situation.

Between 1963 and 1973 the annual rate of increase in the Gross Domestic Product at constant prices in the United King-

dom was only 2.9 p.c. compared with a range of 4.0 p.c. to 5.5 p.c., and an average of 5.0 p.c., for the Communities. Such international comparisons of economic performance are, however, unreliable on account of such factors as changes in the working population and hours worked, definitional difference in National Accounts, reliability of output measures, and the failure of official exchange rates to reflect accurately relative costs. However, the use of the EC National Accounts, the confining of comparisons to the manufacturing sector (which excludes in particular the service sector where measurement is so difficult), and the use of purchasing power parities as opposed to official exchange rates, gives as reliable a comparison as possible. Using this measure the value added per man hour in real terms in 1955 in the manufacturing sector was higher in Germany, France, Belgium and the Netherlands than in the United Kingdom by between 8 p.c. and 18 p.c., by 1973 the levels were between 54 p.c. and 93 p.c. higher¹. In other words by 1973 the United Kingdom had reached a level of value added per man in manufacturing which had been attained by Belgium, France, Germany and the Netherlands in 1965. Italy caught up the United Kingdom in 1968 and labour productivity has been fairly similar in the two countries since then.

Since the oil crisis and world recession which started in the last quarter of 1973 there have been sharp falls in labour pro-

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¹ Cf. D. T. Jones, *Output, Employment & Labour Productivity in Europe since 1955*, National Institute Economic Review, London, August 1976.

ductivity in France, Italy and the Netherlands. The fall in the United Kingdom was, however, smaller. Only in Germany, of the member countries, was there a slow rise in productivity during the recession.

In terms of productivity, therefore, the position of the United Kingdom has declined continually in relation to the other member countries, with the exception of Italy, over the two decades up to 1973. Since then its position has actually improved slightly in relation to Italy, France and the Netherlands. However, failure to take action in relation to inflation during 1974–75 will mean that the United Kingdom's economy will experience an upswing later than that already experienced by other member countries.

Levels of capital investment provide a guide to future economic performance. At the beginning of the 1960s there was a relatively large gap between the United Kingdom and the Six. Some 17 p.c. of the United Kingdom's Gross Domestic Product being devoted to Gross Fixed Capital Formation compared with an average of about 23 p.c. in the Six. During the 1960s Gross Fixed Capital Formation increased slightly as a proportion of Gross Domestic Product in both the United Kingdom and the Six reaching a peak in the Six, but not in the United Kingdom, in about 1970. And whereas the proportion began to fall slightly in the Six during the 1970s it continued to rise in the United Kingdom, with rises in 1973 and the crisis year 1974 greater than at any other time in the previous decade.

Although in 1975 Gross Fixed Capital Formation in real terms in the United Kingdom fell, in common with other member countries, compared with 1974, by the first quarter of 1976 the level had already improved by some 2 p.c. over the fourth

quarter of 1975 at constant prices. According to relative investment figures, therefore, the divergence between the United Kingdom and the Six was less post 1973 than at any point during the decade prior to United Kingdom entry into the Communities.

Rising Trade Deficit

Substantial and continuous trade disequilibrium between a member country of a customs union and the other member countries would question the economic advantage of membership for such a country. In 1975 the United Kingdom's trade deficit with the other members of the Community was £ 2,400 mn, this compared with £ 2,200 mn in 1974, £ 85 mn in 1970 and £ 120 mn in 1966.

On their face value these figures suggest that the United Kingdom trade balance with the other community countries has deteriorated to such an extent as to render further membership of such a customs union questionable or even impossible. No such simple interpretation can, however, be placed upon the figures. The increasing trade deficit with the other Community countries has resulted both from a relative increase in United Kingdom trade with the Community (a rise from about one-quarter of total United Kingdom trade to about one-third in the last decade) and the general deterioration of the United Kingdom's overall trade balance. Indeed the ratio of exports to imports has been fairly similar in both United Kingdom/World and United Kingdom/Community trade in the last few years. Non-membership of the Community during the last four years would, therefore, have probably made little difference to the United Kingdom's present overall trade balance. Although the measures that the United Kingdom must take to rectify its overall trade deficit are incom-

patible with membership of a monetary union, such measures can be compatible with membership of a customs union.

In terms of the above analysis (and it includes only a number of the variables by which divergence could be measured) the rate of divergence between the United Kingdom and the Six was, if anything, greater prior to United Kingdom membership of the Community than since. If divergence is a barrier to economic union, why did the United Kingdom want to join the Community in 1973 given its pre 1973 record in relation to the Six and why did the Six want the United Kingdom as a member?

According to the Preamble of the Treaty of Paris the *raison d'être* of the European Coal and Steel Community was political. Similarly the European Movement (an umbrella organisation for all pro-European organisations in the United Kingdom and with the leaders of the three main political parties as Patrons) commenced its 1970 publication "Britain and the Common Market" with the words "The Basic Issue is Political".

Political Aspects of Membership

The political aspects of the proposed United Kingdom membership of the European Communities were stressed by the leaders of all three main parties in the House of Commons. Mr Jeremy Thorpe, the leader of the Liberal party, (a party which had consistently argued the case of United Kingdom membership) argued, "I want to see a united Europe which disunited has plunged the world into war twice this century. I want to see the political genius of this country coalesce with the industry and perseverance of Germany, with the civilised traditions of France, with the tolerance of the Low Countries and with the artistic genius of Italy".

On 10th May 1967, by a vote of 488 to 62, the House of Commons endorsed the Government's decision to apply for full membership of the European Communities; and in 1971, by majorities of 112 in the House of Commons and 393 in the House of Lords, Parliament agreed to the Government's decision of principle to join the European Communities on the basis of the arrangements negotiated. In January 1973 the United Kingdom joined the European Communities. There was at that time, however, no clear indication on the part of the general public that the decision was favoured. In a survey conducted by the European Commission in September 1973 only 31 p.c. of the people questioned in the UK considered membership of the European Communities to be a good thing for their country whilst 34 p.c. considered it to be a bad thing. Further, only 22 p.c. considered membership to be a good thing for them personally whilst 38 p.c. considered it to be a bad thing.

In the Summer of 1975 the Government held a Referendum on the question of continued United Kingdom membership of the European Communities. The country voted by a 2 to 1 majority to remain in the Communities. The two and one-half years of membership had, therefore, brought with it increasing support for membership on a massive scale. In May 1976 a survey by the Commission showed that support for the Community had declined in the United Kingdom, as it had in the original Six, but a majority still considered membership to be a good thing. Throughout the time of the United Kingdom membership of the Community, therefore, the general public has shown itself to be more favourably disposed to membership than at any point of time prior to membership.

Industry as reflected in the views of the Confederation of British Industries (CBI) has continually favoured membership of the Communities. Political considerations were important to the CBI as shown in its 1975 statement, "Political considerations cannot be divorced from the economic issues in the case of U.K. membership of the E.E.C. The prime objective of the Community, an ever closer union of the European peoples, will serve to preserve peace in Europe"².

Increase in Direct Investment

With impending and actual United Kingdom membership of the Communities after 1970, United Kingdom direct investment in the Communities increased enormously. In the four years 1971-74 inclusive about one-third of total United Kingdom direct investment abroad was in the Communities, i.e. investment in the Community was proportionately twice as important as it had been in the 1960s. In relation to investment the United Kingdom has clearly indicated its faith in the future of the European Communities.

The trades union representatives of industry, however, interpret the investment figures as a lack of faith in the United Kingdom. The Trades Union Congress (TUC) had by a narrow majority in 1972 (after the terms for membership were known) reversed its previous support for United Kingdom membership of the Communities. The following year again by a narrow majority, the TUC voted against the principle of United Kingdom membership. By 1974 the TUC had become strongly opposed to continued membership and to the principle of the European Communities. The increasing direct investment abroad in relation to home investment, particularly in 1973 and 1974, was, at a time of increasing unem-

ployment, an important factor in increasing trade union leaders' opposition to the Communities.

There is no indication, with the exception of the TUC leadership, that support for the United Kingdom membership of the Communities is any less today than it was when the United Kingdom entered the Communities four years ago. The importance of the political implications of the United Kingdom application for membership cannot be overstressed, and it is that political will that will in all probability hold the Community together even when on economic grounds the continued membership of the United Kingdom is being questioned. At the same time it must be emphasised that the economic arguments against United Kingdom membership of the Community are, in 1976, not very different from what they were in the decade up to 1973. There is no more reason today on the grounds of economic divergence for maintaining that the United Kingdom should not be a member of the Community than there was in 1973.

Although it is on economic grounds that the future of the Communities is being questioned, the economies of six of the nine member countries showed remarkable resistance to the recent recession. This bloc of six (Germany, France, Denmark and Benelux) plus Austria, Switzerland and Norway has, in fact, been referred to as the new Stability Bloc³. Future progress in the Community might well imply some kind of tiering arrangement, and even a three tier arrangement if Turkey and Greece become members, but despite the difficulties of such a system the political will in all probability exists to make it succeed.

² British Industry and Europe — A report by the CBI Europe Committee, London, March 1975.

³ F. W. Schulthess, Chairman of the Board of Credit Suisse, Geneva 1975.