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Integration and Convergence

Lessons from Greece's Experience in the European Community

by G. N. Yannopoulos, Reading*

The date of entry of Spain and Portugal into the European Community is drawing ever nearer. What are the likely economic consequences of the integration into the EC of these Southern European countries, whose level of development is quite different from that of the other members? The experience of Greece, the first Southern European country to join the EC, can provide some valuable lessons here.

Despite the preponderance of political and strategic considerations in the decision to enlarge the European Community to include three new members from Southern Europe, the core of the academic writing, research and newspaper discussion has concentrated principally on the economic dimensions of this second enlargement. The concern regarding the economic consequences of enlargement – particularly among the nine other members of the European Community – focused on four main issues.

□ Firstly, the three Southern European countries appear to possess comparative advantages in activities which are declining and problem-ridden in the rest of the Community, notably textiles, clothing, steel and shipbuilding. One would then expect that as the customs union and other common policies are extended to the new members, a relative locational shift southwards in these industries is likely to take place. Such developments are likely to pose a number of problems for the rest of the Community.

□ Secondly, in the field of agriculture, fears have been expressed that surpluses of southern, Mediterranean products would be added to the already existing structural surpluses of northern products.

□ Thirdly, all Southern European countries have been regarded as potentially more demanding on the Community's funds, thus aggravating even more the fiscal crisis of the EEC.

□ Finally, the enlargement of the Community has been viewed as placing serious obstacles to the process of

economic convergence in the Common Market.¹ A backwards step in the process of economic convergence has been viewed as a serious impediment to economic union and as raising further demands for intercountry redistributive transfers within the Community. And it was further pointed out that the emergence of divergent development patterns within the EEC will put a break to the economic growth process for the whole of the Community.²

Greece is of course a small country and any contribution her membership might have made to the emergence of such problems is likely to be marginal although in one area, namely shipping, Greek membership makes more than a marginal difference to the Community. Ironically, in shipping, where Greek membership has unquestionably added to the strength of the EEC, the evidence shows that the Community has so far failed to respond to this challenge by promoting more vigorously in international forums the only policy that would assist the long-run interests of Europe, namely the policy of an open international market in shipping services.

Economic Consequences of Enlargement

Let us start with the first issue, namely the expected relative locational shift of traditional industries towards the new member in the South. Evidence provided by

¹ F. Duchêne: Community Attitudes, in: D. Seers, C. Vaitos (eds.): *Integration and Unequal Development: The Experience of the EEC*, Macmillan 1981.

² D. Seers: *Theoretical Aspects of Unequal Development at Different Spatial Levels*, in: D. Seers, C. Vaitos (eds.), op. cit., pp. 9-23.

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Hassid³ suggests that in Greece at least recent statistics on investment intentions show that traditional industries are strengthening their position. Dr. Hassid interprets this as a rational response on the part of entrepreneurs facing slow-growing demand conditions. Under these circumstances, firms are primarily concerned to strengthen their position rather than enter into new lines of production and diversify their product structures. If demand prospects are not likely to change and firms in the two applicant states respond in a similar manner, then the need for positive adjustment policies at the Community level will become more urgent. Although it is difficult to generalise about the strategic responses of firms to changes in demand and costs, nevertheless such policies are essential not only to help the Northern countries of the Community to cope with the changing patterns of comparative advantage but also to ensure that the new Southern members do not overextend themselves in traditional industries which are likely to lose their advantages in the near future to newly industrialising countries from the Third World.

Agriculture has responded in Greece very much as predicted. Given its complementarity to Community

agriculture, it contributed positively towards the reduction of some of the surpluses of Northern products. Despite becoming a net food importer, Greece has come out of the CAP as a net beneficiary. If the alternative to the present commonly financed policy is nationalisation⁴, then domestic resources equivalent to 1 % of GDP (1983) would have to be diverted from other uses to help sustain the present policy on agriculture.

The experience of Greek agriculture under the CAP is only partly relevant for the Iberian enlargement of the Community. It is relevant in so far as it indicates that production response to price changes in low income, low price, agricultural economies is likely to be substantial. The magnitude of the problem will of course be considerably more sizable. The supply thrust in Mediterranean products will also complicate the

³ Cf. J. Hassid: Trade in Manufactures and Industrial Restructuring – the effects of the first three years of accession on the manufacturing sector of the Greek economy, paper presented at the Conference on the Experience of Greece's Accession to the European Community, University of Reading, England, 29-30 March 1984.

⁴ This is pointed out by L. J. Hubbard, D. R. Harvey: Greece and the Common Agricultural Policy, paper presented at the Conference on the Experience of Greece's Accession to the European Community, University of Reading, England, 29-30 March 1984.

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Kurt Wiesegart

WIRTSCHAFTSKOOPERATION MIT CHINA

– Die institutionellen Rahmenbedingungen –

(ECONOMIC COOPERATION WITH CHINA

– The Institutional Framework –)

The new Chinese economic policy attaches particular importance to the development of China's foreign trade relations. Foreign trade always takes place according to rules which are formed by a whole series of national and international institutions. The present study describes the given institutional conditions for German-Chinese foreign trade relations as well as those still to be negotiated, and offers an appraisal of their effects on trade, cooperation and financial relationships.

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V E R L A G W E L T A R C H I V G M B H – H A M B U R G

delicate balance of preferential trade agreements the Community has with the non-member Mediterranean countries. The Integrated Mediterranean Programmes are a sensible structural policy reform to help the Mediterranean regions of the existing Community to adapt to the new situation. Equally, more positive thinking on the reform of the Global Mediterranean Policy of the Community is needed to alleviate the preference erosion effects that the enlargement of the Community will inflict on the agricultural trade of the non-member Mediterranean countries.

The impact of Greece's membership on the Community's fiscal resources can be looked at from two angles. For Greece, it has been an unmitigated advantage in a period where access to international capital markets for balance of payments finance has become more and more difficult.

Despite the important contribution that fiscal transfers from the Community make to the Greek balance of payments in a critical period for the Greek economy, it cannot be claimed that Greece has been a heavy demander of Community resources even in relative terms. In fact it appears that Greece is underutilising existing financial facilities. Greece has so far absorbed from the structural funds with no predetermined geographical allocations far less than similarly situated economies. Ireland with about one third of the population of Greece absorbed three times as much as Greece from the European Social Fund. Greece has not made any claims for three years from the ex-quota section of the Regional Fund. And claims from the structural funds of EAGGF have been on a per capita basis far more modest than corresponding claims from countries such as Italy and Ireland. The same picture of underutilised facilities emerges from an analysis of the geographical distribution of the lending operations of the European Investment Bank. A number of explanations have been suggested for the relatively low demand placed by Greece on Community finances. One is the lack of organisational efficiency in the Greek state bureaucracy. The other has to do with the restraints placed on the private sector to mobilise itself to the task.

Fear of Economic Divergence

Of all the fears expressed, the perhaps most alarming has been the prospect of economic divergence. It has been argued that the intensification of competition

would give rise to a process of unequal development, growing income gaps and economic decline. Given the existing institutions of the Community, the second enlargement is viewed by some as leading to the peripherisation of Southern Europe.⁵ The opportunities for specialisation and economies of scale offered by the opening-up of markets were thought to be beyond the reach of the semi-industrialised countries of the South. This contention is supported neither by experience nor by economic analysis. The relevant experience here is that of the association of Greece with the EEC. Progress towards partial trade liberalisation during the period 1962-80 was accompanied by a process of economic convergence⁶ with Greece's per capita income rising from about one third of the EEC average at the beginning of the period to about 50 per cent at the end.

However, the analytical basis of the unequal development school is weak and confused. The strength of their argument rests on the presumption that the loss of policy instruments such as tariffs and non-tariff barriers and the constraints placed on the conduct of foreign exchange policy are depriving governments in the European South of essential policy instruments to improve the competitiveness of their industries. This last point may be of relevance in a fully fledged monetary union. It is hardly an issue within the current arrangements of the EMS. As Manassakis has shown⁷, despite the large inflation differentials between Greece and the EEC-9, Greece could have obeyed the EMS rules whilst pursuing the exchange rate policies she followed during 1981-83.

It is implicit in this line of argumentation that continued government intervention through protective trade policies is essential for the acceleration of economic development. In many industrialising countries, however, slow growth and structural balance of payments disequilibria are associated with domestic market distortions caused by misconceived trade and exchange rate policies.⁸ Countries that have passed through their first stage import substitution process⁹ face two choices in their trade and development strategies. They can either proceed to extend their inward-looking strategies to a second stage import substitution policy (involving trade protection measures

⁵ Cf. D. Seers, *op. cit.*

⁶ G. Kalamotousakis: Comparative Productivity Growth – Greece and the EEC Countries: 1955-75, in: Ad. Peplasis et al.: The Tenth Member – Economic Aspects, Sussex European Papers No. 7, Sussex European Research Centre, 1980, pp. 165-195.

⁷ A. N. Manassakis: Greece and the European Monetary System, paper presented at the Conference on the Experience of Greece's Accession to the European Community, University of Reading, England, 29-30 March 1984.

⁸ A. D. Krueger: Trade Policy as an Input to Development, in: *American Economic Review*, Vol. 70, No 2, May 1980, pp. 288-292.

⁹ Cf. B. Balassa: Reforming the System of Incentives in Developing Countries, in: *World Development*, June 1975. Reprinted in: B. Balassa: *Policy Reform in Developing Countries*, Oxford 1977.

to encourage the development primarily for the domestic market of intermediate goods and light machinery products) or to an outward-looking strategy removing the bias against exports by treating sales in domestic and foreign markets equally. In many industrialising countries, particularly those with small or even medium-sized markets, the timely switch to an outward-looking trade strategy is the key factor in maintaining and enhancing the momentum of growth.

Benefits of Export Orientation

The gains to be derived from a reduction in trade distortions following an export orientation in development strategies are well documented in practice. They include greater capacity utilisation, economies of scale, incentives for technological improvement and efficient management under the impact of competitive pressures from abroad. Countries that adopt outward-orientated policies bring their economies closer to an optimal allocation of resources. Given the externality effects of export expansion, marginal factor productivities are higher in the export sector of the economy. By reallocating existing resources from the less efficient non-export sector to the higher productivity export sector, countries pursuing outward-oriented strategies have profited from sustained higher growth rates. As Feder¹⁰ has shown, productivity gains derived from the removal of a bias against exports and the adoption of outward-looking strategies have contributed more than 2.2 percentage points to the growth of the semi-industrialised countries during the period 1964-73.

Membership of a common market contributes towards a partial shift to an outward-looking trade and development strategy. The process of integration into a larger trading block enables the economies of the semi-industrial countries of the European South to benefit from closer-to-optimal resource allocation and the productivity gains associated with such a move. However, the decision to enter into a customs union offers the advantage of a selective outward-looking strategy. Selective, that is, because it removes the anti-export bias of the tariff structures only vis-à-vis a block of countries and not towards the world. Such a selective outward-looking strategy may have its distinct advantages. Whilst it enables the adoption of export-oriented policies, it also offers the opportunities of efficient import substitution policies within a larger market. Efficient import substitution policies may occur even in manufactures such as machinery, since the pre-

accession tariff structures of the semi-industrialised countries of Southern Europe often discriminate against such production. By removing the price distorting effects of inward-looking development strategies, therefore, membership of a trading block enables a semi-industrial country to reap the benefits of the growth-enhancing effects of a closer-to-optimal resource allocation. Integration does not lead to unequal development: it offers opportunities for convergent development.

Such opportunities, to be fully exploited, must be accompanied by appropriate exchange-rate policies and fiscal and monetary policies. The Greek experience clearly demonstrates that following a misconceived exchange-rate policy and insisting on an artificially overvalued exchange rate deprives the economy of the advantages of a more outward-looking trade policy. Yet despite this, trade-creating effects were not altogether absent during the three years of membership. To help the new members to follow the appropriate package of exchange-rate, monetary and fiscal policies, an early entrance into the EMS can certainly be recommended.

However, we should realize that the benefits of an outward-looking strategy materialise through the changes caused in the incentives structure. It is in response to changes in the price signals that the integration-induced resource allocation and growth augmenting effects come about. Price signals work within competitive markets. One serious obstacle faced by Southern European countries is that so much of their production is almost insulated from market competition. A public sector with ever rising operating losses and financial markets run on administrative fiat are distinct characteristics of the Greek economy. Such arrangements can hardly allow positive responses to changing market signals. The adjustment process towards activities which are most likely to reflect the country's long-term comparative advantage is seriously impeded. Broadening the domain of the economy that is coordinated by market signals rather than bureaucratic directives is a prerequisite for success under an outward-looking trade and development strategy. Instead of asking for derogations from the Treaty of Rome rules on competition, governments in Southern Europe should welcome them. The intensification of price and quality competition from abroad creates those very much needed pressures to increase domestic productivity.

One of the most regrettable aspects of current economic policy in Greece is precisely the attempt to isolate a large section of the domestic economy from competitive market pressures. It is no wonder that

¹⁰ G. Feder: On exports and economic growth, in: *Journal of Development Economics*, Vol. 12, 1982, pp. 59-73.

instead of productivity gains we are now witnessing a productivity decline.

Policy Responses

A policy to remove distortions in markets, particularly those due to governments themselves, far from leading to unequal development is in fact an essential ingredient in a package of policy measures to enable the new member of the Community and the applicant members to take full advantage of the benefits of economic integration – benefits such as increased specialisation and economies of scale. Such a package of policy measures accompanying Community membership should include broadening the domain of market institutions, adequate exchange-rate policies and proper pricing policies in the labour and capital markets. These are policy responses to be made by the governments of the new members.

The Community can assist them in this task in many different ways by ensuring that distortions through non-tariff barriers do not replace the removal of tariffs, that the rules of the common competition policy are correctly followed and by welcoming membership in the EMS at an early stage of membership.

There are, however, transitional problems in following such a policy that also require Community response. These are the transitional costs of adjusting to the new market conditions. Adjustment policies are needed for alleviating the short-run social costs of the transition both in the new member countries and in the old member countries of the Community. But what we need here is positive rather than protectionist industrial adjustment policies, policies which will make the closure of the least efficient plants most socially acceptable and which accelerate rather than retard structural change. For it must be accepted that dynamic, new technology sectors cannot grow unless the ailing ones are allowed to shrink. Such a policy, to make sense as a reasonable second-best must be based on a modest degree of selectivity and should place the emphasis on two aspects: firstly, on infrastructure investments with quite broad effects on various industries, rather than on policies that consciously discriminate between industries, firms and products¹¹ and secondly on

generous redundancy payments to the victims of industrial change, related to the potential savings from the closure of inefficient plants rather than to the level of pay and years of service.¹²

The Community does not appear to pursue collectively such a policy. The enlargement of the Community adds new problems to the delayed structural adjustment in Europe.¹³ What is needed here to cope with both the problems of delayed adjustment and the new adjustment issues of enlargement is the establishment at the European Investment Bank of a new Lending Facility for Structural Adjustment to ensure the adjustment of production to the emerging new patterns of division of labour within the Community. Such a facility must be subject to a number of conditions along the lines suggested above. It should certainly not be intended to prolong the agony of the ailing industries, nor should it be channelled to grandiose industrial projects that bear no relation to the dynamic comparative advantage. The experience of the World Bank with a similar facility may be instructive here, although it has been used for slightly different purposes.

One cannot conclude without referring to the impact of economic integration on the current account deficit of the balance of payments. This has been discussed extensively and certainly it is of considerable importance. It would be wrong, however, to emphasise the impact of the integration process on the current account and to overlook the impact on the capital account. Customs unions and economic integration schemes affect simultaneously both the current and the capital account of a country's balance of payments. Due to the asymmetrical effects of tariff dismantling, the current account balance of payments is likely to be adversely affected temporarily. In any case, industrialising countries should be able to raise their sustainable current account deficit if they are to finance the capital imports required for development. However, in the same way as the interplay of trade creation and trade diversion effects is likely to raise the trade balance, so the possibility of investment diversion is also likely to positively contribute to an increase in the level of the sustainable deficit on current account of a member state's balance of payments. But such investment diversion effects materialise only in so far as the perceived risk by foreign investors does not change. This has, unfortunately, not been the case for Greece for reasons which have nothing to do with Community membership. The period of Greece's membership in the Community has so far been a period of missed opportunities. This in itself is an important lesson for the new applicant states.

¹¹ Cf. A. Lindbeck: Industrial Policy as an Issue in the Economic Environment, in: *The World Economy*, Vol. 4, No. 4, December 1981, pp. 391-405.

¹² Cf. L. G. Franco: Industrial Policies in Western Europe – Solution or Problem? in: *The World Economy*, Vol. 2, No. 1, January 1979, pp. 31-50.

¹³ V. Curzon Price: Alternatives to Delayed Structural Adjustment in Workshop Europe, in: *The World Economy*, Vol. 3, No. 2, September 1980, pp. 205-215.