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Intereconomics

Suggested Citation: Axt, Heinz-Jürgen (1991) : Southern Europe facing the single market's completion, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 26, Iss. 4, pp. 192-202,
<https://doi.org/10.1007/BF02926344>

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Heinz-Jürgen Axt*

Southern Europe Facing the Single Market's Completion

The European Community is now starting the final run-up towards the completion of the single internal market by the end of 1992 and member countries are currently involved in consultations at inter-governmental conferences on the creation of economic and monetary union, and on political union. This provides an appropriate opportunity of looking at what belonging to the Community has meant so far to its new members of Greece, Portugal and Spain, and at what their chances are for the future in the light of these developments. What have their entry into the EC and the Single European Act meant to Greece, Portugal and Spain, and what lessons ought to be learned from that?

Membership of the EC demands the operation of a more open, liberalized economy, but at the same time it offers various policies designed to strengthen economic and social cohesion and to allow less developed regions to catch up, especially since the signing of the Single European Act (SEA) in 1986. Indeed, the SEA places its faith in liberalization and cohesion at one and the same time: the EEC Treaty has now been supplemented to provide that the single internal market will be completed by the end of 1992. At the same time, "economic and social cohesion" is stressed as an objective of the Treaty: "The Community ... shall, in particular, set itself the goal of reducing the gap between the various regions and the backwardness of the least favoured areas."

In the remarks which follow, cohesion policy will be understood as the endeavour to give support to the peripheral economies in the Community – Greece, Portugal, Spain, the Republic of Ireland, Northern Ireland and Italy's Mezzogiorno – in their efforts to catch up and to develop in the economic, social welfare and technological fields. Regional policy as such needs to be distinguished from the latter in as far as its area of concern is support for individual areas within just one national economy.¹

The EC's southward expansion was a case of "asymmetrical integration", for the level of development in the new member countries was a substantial way behind the average among the existing members at the time. Having said that, Spain was nevertheless a rather different case from the other two new entrants: its per capita gross

national product at the time it entered the EC (ECU 9,111) lay roughly midway between the values for Greece and Portugal on the one hand (ECU 7,205 and ECU 6,617 respectively) and the average for the previous Community members (ECU 12,684).

Different theoretical approaches exist to the integration between economies with markedly different levels of development, and these are paralleled by equally divergent policy orientations.²

□ One group bases its approach on the *polarization theory*, which assumes that the economies in the EC's core regions possess a number of specific advantages (locational advantages, lower information and transaction costs etc.) which lead to more rapid economic growth there than in the peripheral economies. In this view, unless governmental corrective measures are taken – at national or EC levels – the peripheral economies will not have any chance of keeping pace with the others, let alone of closing the gap on those ahead of them.

□ An alternative approach is based on the *neo-classical theorem* which states that regional differences in

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¹ Cf., among others, Manfred Schäfers, Joachim Starbatty: Das Instrumentarium der EG zur Förderung innergemeinschaftlicher Kohäsion, in: Aus Politik und Zeitgeschichte, Vol. 28, 6th July 1990, pp. 3-15.

² Cf. Dieter Biehl et al.: Zur regionalen Einkommensverteilung in der Europäischen Gemeinschaft, in: Die Weltwirtschaft, 1972, No. 1; ditto: Ursachen interregionaler Einkommensunterschiede und Ansatzpunkte für eine potentialorientierte Regionalpolitik in der Europäischen Gemeinschaft, in: Hans von der Groeben, Hans Möller: Möglichkeiten und Grenzen der Europäischen Union, Vol. 2: Verteilung der Kräfte im Raum, Baden-Baden 1980, pp. 71 ff.; Christiane Krieger et al. (eds.): Regionales Wirtschaftswachstum und Strukturwandel in der Europäischen Gemeinschaft, Tübingen 1985; Elisabeth Lauschmann: Grundlagen einer Theorie der Regionalpolitik, Hannover 1976; Ewald Nowotny: Regionalökonomie – Eine Übersicht über Entwicklung, Probleme und Methoden, Vienna 1971.

development will be balanced out over time by way of price and cost differentials if greater freedom of movement is given to the factors of production. This approach places its faith in liberalization and in self-regulatory market forces, thus contradicting the theory of unequal development. The line is that integration does not consolidate divergences in development, but rather that it provides the opportunity for convergence.

It will be apparent from this theoretical background that the Single European Act represents a compromise between the liberalization of market forces and the controlling influence of governments. The programme to establish the single internal market is in line with neo-classical concepts of integration, whilst the cohesion policy at the same time takes account of the misgivings that it might encourage polarization. There can of course be no mistake that this compromise solution was virtually the only way of gaining political acceptance for the SEA within the Community, and the less developed member countries were ultimately able to use their powers within EC governing bodies to have the policy of cohesion built into the Act, later securing the doubling of the volume of the Structural Funds and making sure that their applicability would be concentrated on the regions with weaker economies.

Having outlined these background considerations, it is now possible to pose the questions one would like to obtain an answer to in the empirical analyses below: What effects of entry can be ascertained in the three Southern European countries after their relatively short period within the Community, and what are the instruments used to execute cohesion policy, on what scale, and with what consequences?

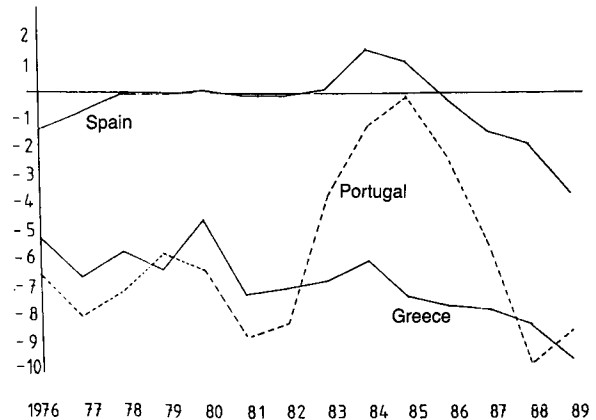
Effects of Liberalization

The current level of sophistication in research on integration makes evaluating integration effects a problematical affair. The difficulties arise both in establishing what changes have actually occurred and then in attributing them to specific causes. Thus a number of static effects which have resulted from EC membership can be ascertained, but not what dynamic changes those effects may have generated. The main problem, though, is that of attribution. How can an effect be linked to EC membership without the knowledge of what would have happened if the country concerned had not joined the Community?

The establishment of a customs union always brings with it changes in trade flows. The obligation to liberalize trade which went with EC membership (involving reductions both in tariffs and in other barriers to trade) also

Figure 1

Balance of Intra-EC Trade as Percentage of Gross Domestic Product, 1976-1989



Sources: Eurostat: Außenhandel, Statistisches Jahrbuch 1990, p. 59; Eurostat: Revue Rassegna 1977-1986, p. 35; Eurostat: Statistische Grundzahlen der Gemeinschaft, Luxembourg 1990, p. 37; EC Commission: The impact of the internal market by industrial sector: the challenge for the Member States, European Economy, special edition, Luxembourg 1990, p. 73.

had a lasting detrimental effect on the intra-EC trade balance of all three newly joining countries. This change is apparent in Figure 1, where there can be seen to have been a substantial deterioration in the balance of trade in all three countries, as a result of a wave of imports from the EC. Greece's deficit was still just 4.5% of its gross domestic product in 1980, but that share had shot up to 7.2% in 1981. The corresponding figures for Portugal are the 0.1% deficit it had in 1985 which rose to 2.3% in 1986. In Spain, a small surplus of 1.2% of GDP in 1985 turned into a deficit of 0.3% the following year.

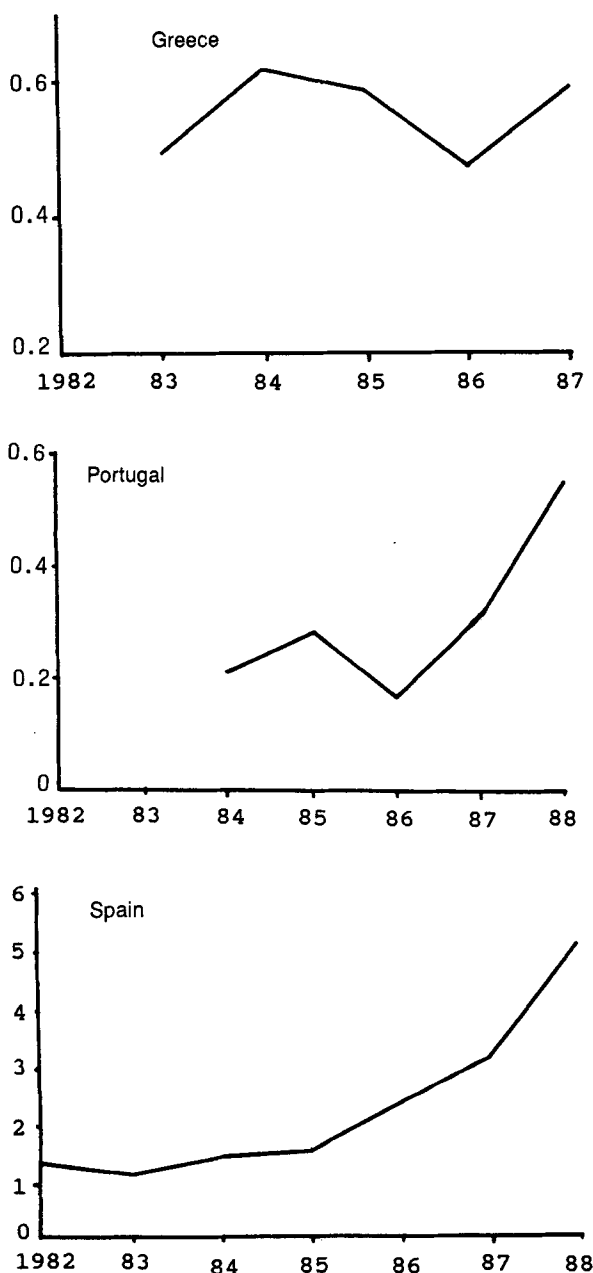
Although an important part is attributed to net transfers to the new member countries from the EC budget, a still more important factor would nevertheless appear to be private-sector imports of capital, particularly in the form of direct investment. The latter is expected to help build up modern industries, to create jobs, to increase productivity and to raise the overall technological level.

Since their entry into the EC in 1986, direct investment in Spain and Portugal has risen strongly (cf. Figure 2). Foreign investment in Portugal in 1988 was three times that in 1984, while there was a fourfold increase in Spain. In both countries, then, investment from abroad acted as a substantial stimulus to total investment.³ In Spain, the

³ Cf. EC Commission: The impact of the internal market by industrial sector: the challenge for the Member States, European Economy, special edition, Luxembourg 1990, pp. 70 ff.; Joachim Volz: Spanien vor und nach dem Beitritt zur Europäischen Gemeinschaft: Von der Krise zu dynamischem Wachstum mit neuen Problemen, in: DIW-Wochenbericht, Vol. 57, 1990, No. 16, pp. 214-220.

former expressed as a share of GDP grew from 0.7% to 1.7% in the period concerned, and it went up from 3.8% to 7.8% as a proportion of gross capital formation. Estimates have been made that 35% of all investment in Spanish manufacturing industry between 1986 and 1988 was made with foreign capital. In Portugal, too, the share of foreign investment in GDP increased from 0.9% in 1984 to 1.6% in 1988, while the shares of gross capital formation were 3.7% and 5.6%.

Figure 2
Direct Foreign Investment, 1982-1988
(in ECU billion)



Source: EC Commission: The impact of the internal market, op. cit., p. 82.

In Greece, on the other hand, foreign investment has stagnated, coming to approximately the same level in 1987 as in 1984. This is reflected in the share of such investment in GDP, which was 1.4% in both 1984 and in 1988. Studies on the situation in Greece which have investigated capital movements since the country's accession to the EC have drawn similar conclusions, showing that the expectations that joining the Community would generate huge capital imports have not been fulfilled.⁴ On the contrary, a marked increase in capital exports out of Greece has been apparent, even though the government in Athens did not comply with the rules it had agreed to in its treaty of accession which were meant to allow the free movement of capital.⁵ To summarize, Greece differs from Spain and Portugal in that foreign investment has not contributed to injecting greater dynamism into its economy. Rather, stagnating levels of direct investment were both a contributory cause and a result of generally unfavourable economic developments and of the failure to carry out structural change.

Instruments of Cohesion Policy

Having pointed out some effects of liberalization above, the following remarks will focus upon the policy of cohesion. This policy was by no means unheard of prior to the Single European Act, but the Act did explicitly state it as a responsibility of the Commission expressed in the EEC Treaty for the first time. There are two institutions in the EEC Treaty which are still of importance today for cohesion policy, namely the European Social Fund (ESF) and the European Investment Bank (EIB). After the first expansion of the EC in 1973, and in view of the low level of economic development in Ireland and Northern Ireland relative to the rest of the Community as it then stood, the European Regional Development Fund (ERDF) was established in March 1975.

The Integrated Mediterranean Programmes (IMPs) can in a sense be regarded as a precursor of the policy of cohesion as it is codified in the Single European Act. The objective of the IMPs has been to improve the socio-economic structures in Southern Europe, in order to give

⁴ Cf. Dimitris Seremetis: *Chrimatikes Scheseis tis Elladas me tis Europaikies Koinotites. Epiptoseis tis Entaxis 1981-1985*, Idrima Mesoyeiakon Meleton (Mediterranean Research Foundation), Athens 1989.

⁵ Greece was, it is true, permitted in its treaty of accession to postpone establishing freedom of capital movements for direct investment from EC sources until 1985. Yet even in 1988, Pavlos Katsioupis (*Die Integration des griechischen Bankensystems in die EG*, Frankfurt am Main etc. 1988, pp. 373 f.) still found that certain sectors were walled off against direct investment (banking and insurance, mining, shipping and real estate in border regions), and that Greek civil service departments were still entitled to examine investment proposals and check their appropriateness according to a criterion of "economic need", following which they could reject the proposals.

the affected regions a better chance of adjusting to the admission of Spain and Portugal to the EC. The IMPs are integrated regional development programmes, and as such they mobilize funds at the EC, national government and municipal levels and put them to use in a comprehensive development strategy. The programmes' beneficiaries are Greece and certain regions of France and Italy. The funds are deployed in a focused way rather than spreading them among countless individual projects. The total amount of EC funds available for the seven-year period from 1986 to 1992 is ECU 6.6 billion.⁶

Two special development programmes for Portugal were set up in 1988, one for industry (Programa Especifico de Desenvolvimento da Industria Portuguesa – PEDIP) and the other for agriculture (Programa Especifico de Desenvolvimento da Agricultura Portuguesa – PEDAP). In addition to measures taken by the Structural Funds, PEDIP is making another ECU 500 million available for the period 1988 to 1992. The following four core objectives are being followed: extending basic infrastructure for industry, providing occupational training and further training, encouraging investment and raising productivity, with the highest priority being attached to the latter two objectives.

In accordance with the provisions of the SEA, the European Council of Ministers agreed in Brussels in February 1988 to concentrate the resources of the Structural Funds and to double their volume in real terms compared to 1987 by 1993. The Structural Funds comprise the Regional Fund, the Social Fund and the European Agricultural Guidance and Guarantee Fund (EAGGF) – Guidance Section. The central aim ("goal no. 1") was stated as giving encouragement to regions which are behind others in their economic development. The Structural Funds are required to coordinate the support they provide. Support for "backward" regions may take up anything up to four-fifths of the total Regional Fund.

In the newly admitted countries of Southern Europe, the regions qualifying for support include all of Greece and Portugal and large areas of Spain. The Federal Republic of Germany, by comparison, does not have any qualifying regions. Funds are distributed according to a three-stage procedure: First of all, development plans are drawn up by member countries' governments, which are then vetted and changed if necessary in negotiations with the EC Commission, before finally being implemented in

operational programmes. Apart from the basic principles of programming, decentralization and partnership, funds are also granted on the understanding that they only supplement expenditure which is already proposed at the national level.

A further instrument of the cohesion policy for assisting economically weaker countries is the European Investment Bank. Acting as an autonomous organization, the EIB puts up investment funds to contribute to economic policy convergence. A large majority of this money goes to the peripheral regions. The EIB funds its lending operations via the capital markets both inside and outside the Community. Its top-class, "triple-A" credit rating means it can raise its funds at very favourable rates, before passing them on to its borrowers at a 0.15% premium to cover its operating costs. Among the EIB loans oriented to regional policy objectives, two-thirds go to regions which have a relatively low level of development. Italy has drawn the greater part (40%) of the funds lent to date, followed by Spain (14.7%), France (9.9%), Portugal (9.2%) and the United Kingdom (8.4%), while Greece's share is below 5%.

Simultaneously with the reform of the Structural Funds, the European heads of government also initiated a reform of the EC's budgetary mechanisms at the Council of Ministers meeting in Brussels in February 1988. The motive behind these changes was to relieve some of the burden on the less-developed economies. This was carried out by introducing a fourth source of income proportional to the GNP of member countries.

Net Transfers

Of the sums flowing to individual member countries out of the EC budget, the majority are payments by the Guarantee Section of the EAGGF agricultural fund, or in other words payments which do not have any structurally innovative effect. In 1989, agricultural guarantee payments accounted for 72% of the funds distributed to member countries, and structural payments 23%.⁷ Thus funds deployed in support of cohesion policy actually only play a modest part within the EC budget as a whole. In spite of the improvements which have been achieved, agricultural subsidies still consume a vast share of the EC's funds.⁸

⁶ ECU 4.1 billion of these are drawn from the Community budget, and the remaining ECU 2.5 billion are being supplied by the European Investment Bank and the "New Community Instrument" (NCI). The NCI, which is also known as the "Ortoli facility", was created in 1978 in order to finance investment schemes contributing to greater convergence and to economic policy integration.

⁷ Loans and adjustment schemes implemented in accordance with Art. 56 of the ECSC Treaty are not considered among the structurally effective transfers below. Up to 1989, Greece had received ECU 5.1 million of such payments, Spain ECU 147.8 million and Portugal ECU 22.8 million.

⁸ 1989 was the first year in which there was an absolute fall in guarantee payments, from ECU 26,389 million the previous year to ECU 24,403 million. In 1988, guarantee payments took 73% of the budget and structural payments only 18%, so some improvement is now apparent.

Greece received a little over ECU 3.8 billion from what are now the Structural Funds between 1981 and 1989, while Spain also received ECU 3.8 billion between 1986 and 1989, and Portugal was paid ECU 2.1 billion in the same period.⁹ Relative to total Community expenditure on structural policy, Greece managed to gain a share of 11% (1981-1989), Spain 15% and Portugal 8% (both 1986-1989). The Regional Fund played the quantitatively greatest part in supplying structural assistance. In Greece's case, it accounted for 61% of the payments from all three Structural Funds, in Spain 57% and in Portugal 53%. With its 21% share, the Social Fund played a lesser part as far as Greece was concerned. Spain and Portugal, by way of contrast, took 36% and 34% respectively of their structural payments from this source. The difference is balanced out again by the greater proportion of funds Greece drew from the Guidance Section of the EAGGF (18% as against 7% and 13% respectively for Spain and Portugal).

Greece's share of all payments actually made by the Regional Fund ranged between 15.2% and 16% from 1981 to 1984, but then after peaking briefly at 19% in 1985, fell off steadily from 12.4% in 1986 to 10.6% in 1989. Lack of demand undoubtedly does not provide an explanation for this, and apart from the effect of the Iberian countries' entry beginning to show through, some responsibility probably also lies with the Greek applicants themselves. As

mentioned above, regional support payments are only provided on the condition that the applications submitted by a member country are also accepted by the Commission.¹⁰

I turn now to another of the structural policy instruments already mentioned, namely EIB loans. In 1989, such loans were taken out in Greece to the sum of ECU 271.4 million, in Spain ECU 1,541.7 million and in Portugal ECU 755.7 million. Up to and including 1989, the total sums received by the three countries were ECU 2,696 million for Greece, ECU 4,226.9 million for Spain and ECU 2,621.3 million for Portugal. It is immediately apparent that Greece, though it had been a member for five years longer, has hardly absorbed any more EIB funds than Portugal.¹¹ The relatively modest share of Greece's EIB borrowing compared with that of the Iberian countries is confirmed by the fact that the proportion of total investment in the country which had been financed in whole or in part by the EIB 1988 was 7.2% for Greece, but 10% for Spain and as high as 13% for Portugal.¹²

In 1989, Greece and Portugal (together with Ireland, the Netherlands and Denmark) were among the net recipient countries within the EC, i.e. their contributions to the EC budget were less than the payments they received.¹³ Of course, it is impossible to have net recipients without there being some net contributors, and in the EC in 1989 these were West Germany, France, the United Kingdom, Italy,

⁹ Cf. Court of Auditors: Jahresbericht zum Haushaltsjahr 1985 zusammen mit den Antworten der Organe, in: Amtsblatt der EG (= EC Official Bulletin), Vol. 29 (15th Dec. 1986) C 321, p. 178; Court of Auditors: Jahresbericht zum Haushaltsjahr 1987 zusammen mit den Antworten der Organe, in: Amtsblatt der EG, Vol. 31 (12th Dec. 1988) C 316, p. 224; Court of Auditors: Jahresbericht zum Haushaltsjahr 1988 zusammen mit den Antworten der Organe, in: Amtsblatt der EG, Vol. 32 (12th Dec. 1989) C 312, p. 228; Court of Auditors: Jahresbericht zum Haushaltsjahr 1989 zusammen mit den Antworten der Organe, in: Amtsblatt der EG, Vol. 33 (12th Dec. 1990) C 313, p. 76.

¹⁰ Sources from within the EC Commission also report that Greece has not been properly taking advantage of the structural payments for which it would be eligible. Cf. Financial Times, 8th May, 1990, p. 4.

¹¹ Cf. Bernhard Seidel: Sozial- und Regionalpolitik, in: Werner Weidenfeld, Wolfgang Wessels (eds.): Jahrbuch der Europäischen Integration 1989/90, Bonn 1990, pp. 167-177, esp. p. 172.

¹² Cf. Manfred Schäfers, Joachim Starbatty, op. cit., p. 7.

¹³ For the sources of these and the following data, refer to footnote 9.

PUBLICATIONS OF THE HWWA-INSTITUT FÜR WIRTSCHAFTSFORSCHUNG-HAMBURG

E. Ulrich Cichy

Large octavo,
256 pages, 1990,
price paperbound,
DM 65,-
ISBN 3-87895-391-7

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Belgium, Luxembourg and Spain. It should be said here that Spain appeared as a net contributor for the first time in 1989, having previously numbered among the net recipients. The cumulative net transfers to Greece from 1981 to 1989 were something over ECU 10.2 billion, while Spain received almost ECU 1.7 billion between 1986 and 1989, and Portugal ECU 1.6 billion. There are considerable differences between the three countries in the flow of funds, for Spain received roughly 1.5 times the value of its contributions to the EC in 1988, while the ratio was 4.5:1 in Greece and 8:1 in Portugal.

If the net sums received by each country are calculated on a per capita basis, the citizens of Ireland received ECU 327 apiece in 1988, those of Greece ECU 149, of Portugal ECU 50 and of Spain ECU 34.¹⁴ If GDP is taken as a measure, then the gross contributions made by the Southern European countries roughly correspond to their share of the gross domestic product of the EC as a whole.¹⁵

As mentioned earlier, Greece receives special assistance under the Integrated Mediterranean Programmes. During the period 1986-1992, it will have received a total of ECU 1.8 billion from the EC budget. EIB loans in the same period will be ECU 575 million, and governmental bodies in Greece itself will have added another good ECU 1 billion. Thus the total expenditure to be financed within the framework of the IMPs comes to over ECU 3.2 billion. For the sake of comparison, France's allocation from the Community budget was ECU 360 million and Italy's was just over ECU 1 billion.

Industrial development in Portugal is supported by the EC via the PEDIP programme. This involves the provision of ECU 100 million per year by the Community in additional funds, as an extra budgetary item on top of Structural Funds activities and lending by EC bodies. Special encouragement is given to investment incentives and measures to increase productivity, which account for 78% of the additional funds placed through the programme.

Net Benefits or Costs?

It is easier to assess the quantitative effect of the EC's cohesion policy to the benefit of the Southern European countries if the support is seen as a proportion of gross domestic product. Taking the case of Greece first, if payments from the Structural Funds are added to the annual EC transfers (as booked) under the Mediterranean

programmes and also to loans provided by the EIB, the total sum transferred in 1988 came to 2.3% of the country's GDP. The equivalent proportions for the Iberian countries are 0.7% for Spain and 3.7% for Portugal; they did not benefit from the IMPs, but Portugal received support via PEDIP and PEDAP instead. When seen in terms of GDP, then, the EC transfers received by these countries are quite considerable.

Against this, it has to be borne in mind that membership of the EC not only brought financial transfers into the newly joining countries, but also placed a substantial additional burden on their trade balances with other member countries. If these intra-EC trade deficits are also measured as a proportion of GDP, the 1988 results come out at 8.3% for Greece, 1.8% for Spain and 9.7% for Portugal.¹⁶ Surveys dealing with Greece, the country with the longest EC membership of the three, have shown that the increase in imports from elsewhere in the Community resulting from liberalization can be estimated at about one-third of the country's overall intra-EC trade deficit.¹⁷ Even if one follows this rule of thumb and only interprets a portion of the trade deficit as a consequence of EC entry, this nevertheless casts the positive effect of EC transfers to the Southern European countries in a substantially different light.

Effects of the Policy of Cohesion

Against the background of the theoretical positions considered in the opening paragraphs, the conclusions of the empirical analyses can be summarized in five points as discussed below:

1. For the period which has elapsed so far, the financial transfers which have been made to the new member countries in connection with the policy of cohesion have to be regarded in economic terms as compensation for the liberalization effects associated with joining the EC, and in political terms as a necessary gesture for the sake of retaining popular loyalty to the Community in the new member countries.

As shown by the empirical surveys, the liberalization effects in the form of major import waves of goods and services from the other EC countries are certainly not to be

¹⁴ Calculated from the data as in footnote 9, together with OECD: Greece. Economic Survey 1990, Paris 1990, pp. 112 ff.

¹⁵ The figures for 1986 were as follows: Spain, whose GDP accounted for 6.6% of the EC total, contributed 7% of the budget, for Greece the figures were 1.1% and 1.9% respectively, and for Portugal 0.8% in each case.

¹⁶ Calculated from the data sources given in Figure 1.

¹⁷ This result is obtained by calculating the difference between the actual intra-EC trade deficit and the deficit which would be estimated to have occurred if it had gone on increasing at the same pace which was observed prior to EC entry. The actual increase in the deficit was substantially greater. On this, cf. Heinz-Jürgen Axt: Griechenland in der Europäischen Gemeinschaft. Kosten und Nutzen der griechischen EG-Mitgliedschaft, in: Österreichische Zeitschrift für Politikwissenschaft, Vol. 16, 1987, No. 2, pp. 169-187.

underestimated. Increased trade deficits, and usually also current balance deficits, lead to higher levels of borrowing, thus tying up more funds for debt amortization in the future and restricting the amount available for productive investment, which only goes to prolong the time needed to achieve structural economic changes. Yet these are precisely what is so urgently necessary in the new member countries, for it is only by improving their competitiveness that domestic suppliers of goods and services in those countries can be expected to hold their own against their counterparts from the rest of the EC.

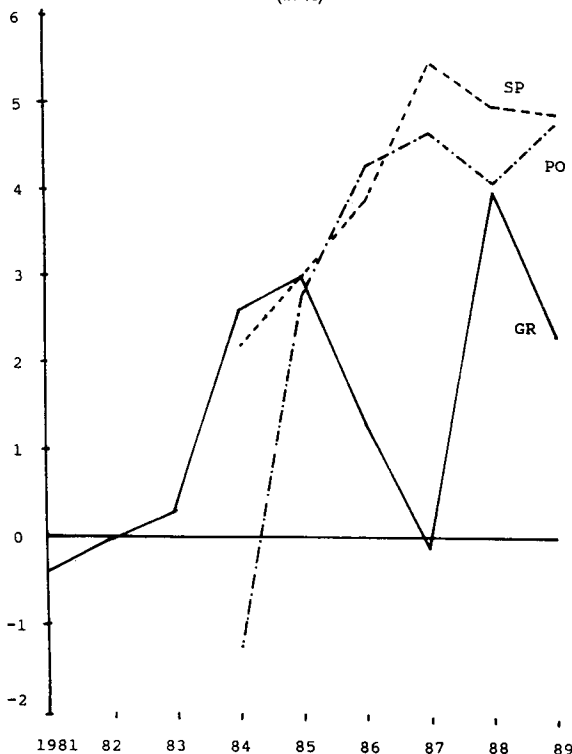
The true purpose of the policy of cohesion is to make funds available to increase investment potential in the same way as savings in the domestic economy would do, thus helping to reduce the development gap. However, the pursuit of this objective is impaired if the transfer payments have to be used in the first instance to ease the burden on the balance of payments in the newly joining countries which has been generated by the wave of imports from other Community members. Thus, in reality, the primary aim of the cohesion policy would appear to be less one of

financing structural change than of compensation for the trade deficits in which EC entry has played such a large part.

Political bodies in the new member countries have thus demanded compensation for the import burden of entry and, given the mechanisms by which power is distributed within the EC, have also been able to enforce those wishes.¹⁸ However, the other side of this picture is often a form of "due-collecting" mentality, in which it is enough for the politicians to show that they have collected enough "dues" from Brussels, without any need for them to deploy the funds in promoting structural change in order to gain the loyalty of their electorate.

In past years, then, cohesion policy has had a strong hint of political "horse-trading" about it: Greece, for example, was only prepared to give its vote to the Single European Act if economic and social cohesion were insured. Likewise, the Athens government did not relax its intention to veto Spain's and Portugal's entry until the Integrated Mediterranean Programmes had been put into operation. Even today, cohesion policy still has yet to be firmly established within the EC's budgetary system as a general principle. The strong bias towards agricultural payments which still afflicts the EC budget despite the visible improvements which have been made underlines the urgency of this task.

Figure 3
Year-on-Year Growth of Real Gross
National Product
(in %)



Sources: OECD, IMF, EC Commission, and national statistics. Compiled from the economic policy articles in: Wolfgang Wessels, Werner Weidenfeld (eds.): *Jahrbuch der Europäischen Integration 1983 ff.*, Bonn 1984 ff.

The Role of National Economic Policies

2. *The new member countries from Southern Europe have differed in the use they have made of the opportunities offered to them by the Common Market: positive trends are apparent in Portugal and Spain, whereas Greece looks as if it will soon occupy last place within the Community. Evidently, EC cohesion policy can only be effective in a subsidiary role, and economic policy within the country itself still carries the main responsibility for how an individual EC member state fares.*

Even if the effects of the EC's cohesion policy are taken to be only modest while the initially adverse effects of liberalization are serious, that is still an insufficient explanation for poor economic performance in a new member country. Indeed, a comparison between Portugal and Greece provides immediate evidence that these two new entrants, with similar levels of economic development and facing quite comparable problems as a result of entry, are indeed heading in different directions.

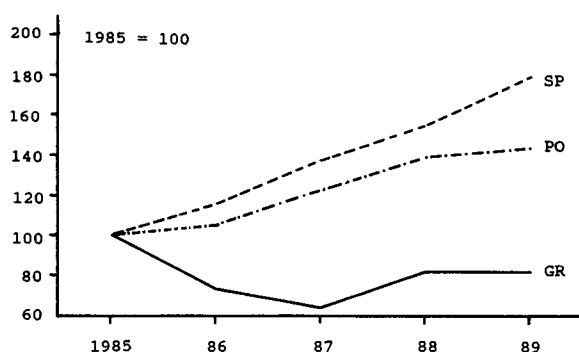
¹⁸ Cf. considerations on the "political economy" of governments' behaviour, in which they are said to use trade policy as a means of ensuring their own re-election. Cf. Robert E. Baldwin: *Rent-seeking and Trade Policy: An Industry Approach*, in: *Weltwirtschaftliches Archiv*, Vol. 120, 1984, pp. 662-677; Robert C. Hine: *Customs Union Enlargement and Adjustment: Spain's Accession to the European Community*, in: *Journal of Common Market Studies*, Vol. 28, 1989, No. 1, pp. 1-27.

At the time it entered the EC in 1981, Greece was in an economic recession, and activity did not recover properly throughout the 1980s. By contrast, the upward cycle Portugal and Spain had been enjoying was stabilized following their entry into the Community. The reason for these contrary developments evidently lies in the fact that the supporting measures provided by the EC were put to very different uses in different countries.

Figure 4

Investment in Manufacturing Industry

(Volume indices)

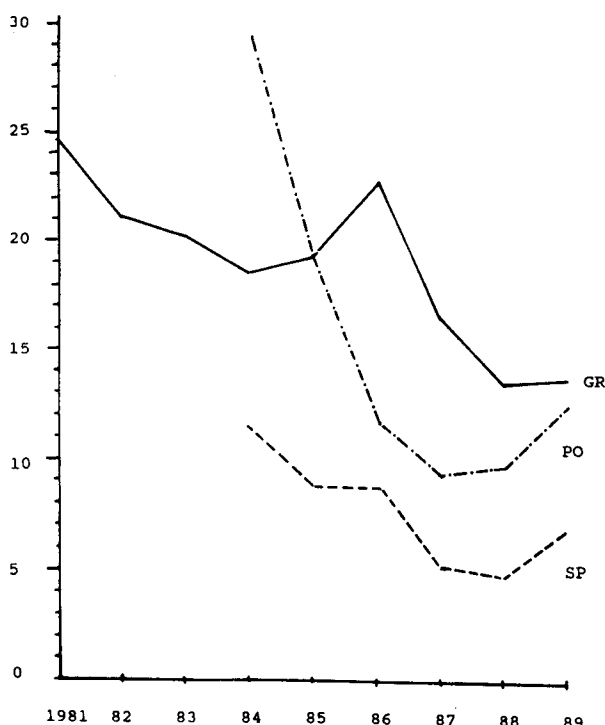


Source: EC Commission: The impact of the internal market ..., op. cit., p. 72.

Figure 5

Year-on-Year Increase in Retail Prices

(in %)



Source: As for Figure 3.

The trends in direct foreign investment in the eighties shown earlier (cf. Figure 2) were in themselves a clear indication that the economies of the three Southern European new-member countries were not moving in unison. As was also indicated above, Greece has not made sufficient use of the opportunities offered by EC membership: the Regional Fund allocation is evidently not being fully taken up, while the relatively modest demand for EIB loans is itself a reflection of Greece's generally low propensity to invest during the 1980s.

Figures 3 to 7 show the changes in a number of economic indicators in all three new member countries. Although Greece's real growth rate after 1981 did increase slightly at first, that increase was not sustained. By way of contrast, the growth of GNP in Spain and Portugal has continued unabated since they joined the EC in 1986 (cf. Figure 3). Figure 4 shows one of the key weaknesses of Greek industry, namely its totally inadequate investment level. Since 1985, there has been a marked fall-off in Greece's investment in manufacturing industry in comparison with the EC average, and especially with the levels in the two Iberian countries. This is a continuation of a trend which has been in evidence since the early 1980s: the reduction, at constant prices, in investment and especially in private capital formation.¹⁹

A noticeable feature of the movements in inflation rates (see Figure 5) is that the low level of GNP growth in Greece has been accompanied by high rates of price increases which have only fallen off gradually. Spain's inflation rate was much lower during the 1980s, while Portugal's came down much more quickly. In 1989, however, there were signs of the inflation rate increasing again in the Iberian countries. Spain's central economic problem, as indicated in Figure 6, is a high rate of unemployment, which is a less serious problem in Greece and Portugal. Finally, Figure 7 again brings out Greece's unfavourable balance of payments situation: as a proportion of the country's GDP, Greece's current account deficit is markedly higher than Spain's or Portugal's. All three countries underwent homologous changes in as far as all of their current accounts were considerably weaker after EC entry. The reason lies in the increased deficit on the balance of trade which could only partly be compensated for by services (tourism, shipping).

Spain's relatively favourable economic course when viewed in terms of the indicators which make up the "magic rectangle" (growth, balance of payments, inflation and unemployment) can be explained as a result of the

¹⁹ Cf. Panos Kasakos: Entwicklungsprobleme und wirtschaftspolitische Optionen im Griechenland der achtziger Jahre, in: *Aus Politik und Zeitgeschichte*, B 14-15/88, 1st April 1988, pp. 36-46, esp. p. 39.

thorough implementation of the "two-phase" strategy put forward by Felipe Gonzalez, that modernization and the strengthening of competition should come first, to be followed by more favourable social and welfare policies.²⁰ In the Spanish government's view, any other approach would have operated as a disincentive to investment from home and abroad. The PASOK government in Greece put the two phases the other way round, with sobering results. In Spain, a major say in developments was given to economic technocrats, and a great deal of modernizing, rationalizing and privatizing was done as the state withdrew from its traditional business role and the labour market, which had previously been extremely rigid, was made "more flexible". The particularly vulnerable aspect of this moderate version of supply-side economics thus proved to be, and indeed still is, unemployment.

The positive economic trends in Portugal were largely externally generated, by a large volume of foreign investment.²¹ Portugal was attractive because the right kind of operating framework had been created for investors. The new constitution did not indulge in any socialist rhetoric, and reprivatization began to move on apace. Labour law, too, was deregulated. On the other hand, some observers are sceptical as to whether Portugal's growth would manage to perpetuate itself if foreign investors were to lose interest at some stage.

There are so many different reasons behind Greece's economic problems that it would be wrong to give an oversimplified explanation. It is nevertheless possible to point out a number of the weak points in the economic policies which have been followed since 1981, which was both the year Greece entered the EC and the year the socialist, PASOK government came to power.²² Some of these are associated with traditional problems which have still not been solved today.²³

²⁰ Cf., among others, Wolfgang Merkel: Sozialdemokratische Politik in einer post-keynesianischen Ära? Das Beispiel der sozialistischen Regierung Spaniens (1982-1988), in: Politische Vierteljahresschrift, Vol. 30, No. 4, pp. 629-654; A Survey: Who speaks for Spain?, in: The Economist, Vol. 310, No. 7593, pp. 1-22; Joachim Volz, op. cit.; George N. Yannopoulos: European Integration and the Iberian Economies, London 1989.

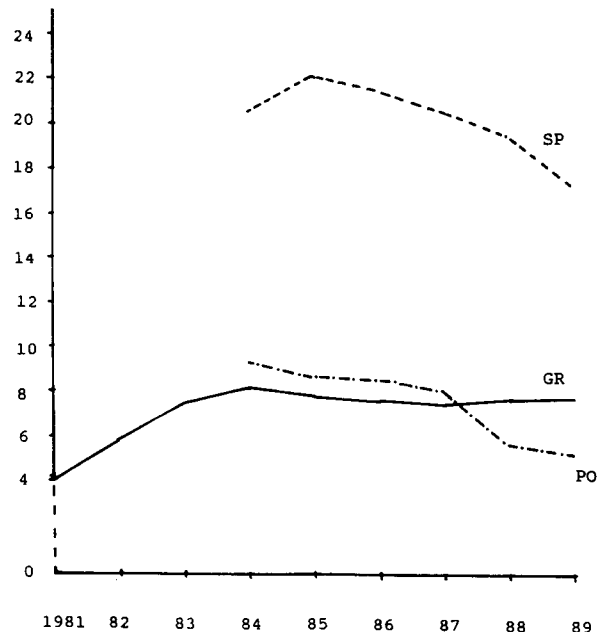
²¹ Cf., among others, Michael Dauderstädt: Schwacher Staat und schwacher Markt: Portugals Wirtschaftspolitik zwischen Abhängigkeit und Modernisierung, in: Politische Vierteljahresschrift, Vol. 29, 1988, No. 3, pp. 433-453; Daniela Kreidler-Pleus: Der EG-Beitritt Portugals. Wirtschaftliche, politische und rechtliche Grundlagen, Frankfurt am Main 1990.

²² Cf., among others, the OECD Economic Surveys for 1983, 1987 and 1990; Panos Kasakos, op. cit.; Heinz-Jürgen Axt: Die PASOK. Aufstieg und Wandel des verspäteten Sozialismus in Griechenland, Bonn 1985.

²³ The liberal/conservative government under Mitsotakis is also making heavy weather of pruning back the public sector. Its workforce has not yet been reduced, and indeed there has not even been a recruitment freeze. Nor, as yet, have any of the state-owned "problem enterprises" been privatized.

Figure 6

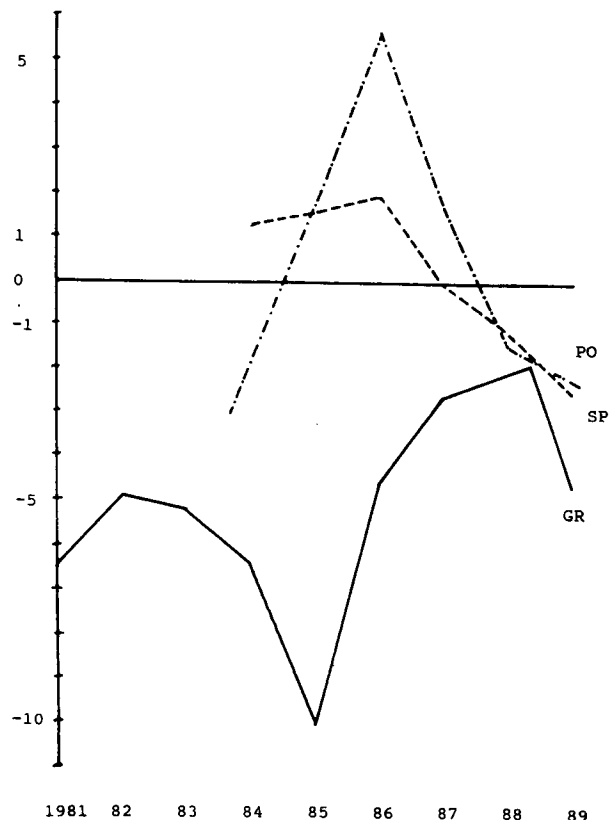
Unemployment as Percentage of the Workforce



Source: As for Figure 3.

Figure 7

Balance on Current Account as Percentage of GDP/GNP



Source: As for Figure 3.

Thus the classical tendency of looking after one's chums took on a particular virulence in its "socialist" variant from 1981 onwards, as the public sector was expanded in order to create more positions for party supporters. 50% of the government budget was spent on salaries and pensions, and between 300,000 and 400,000 new public-sector employees are reckoned to have been taken on during PASOK's period of government.²⁴

There was a drastic increase in the public sector share of GNP, from 30% in 1980 to 49% in 1985, and that share is believed to be as high as 70% today. A particularly worrying development has been the associated doubling of new borrowing because most of it has gone to finance consumption expenditure. The public sector grew larger and larger as the state took over control of so-called "problem companies". For political reasons, the intention was to thus avoid redundancies, but the result is that none of these companies has been made any more profitable.

In a general sense, too, Greece was living beyond its means in as far as the expansionary budgetary and incomes policies, inspired by a combination of left-wing politics and Keynesian economics, were unable to spur growth in the economy. The use of government money for welfare and consumption diverted it away from investment. Under these circumstances, the large increases in nominal incomes were bound to be gobbled up by equally rapid inflation. Further problems also arose because there was hardly even a hint of constancy in demand management and economic policy. A number of sudden policy U-turns were made in the economic field when electoral considerations appeared to call for them.

To summarize, the funds made available under the EC's cohesion policy can "disappear into thin air" if they coincide with government policies in the peripheral economies which do not motivate domestic entrepreneurs to engage in innovative investment or which do not make the country an attractive prospect for direct foreign investment.

Prospects

3. The developments which have occurred since the Southern European countries' entry into the EC are again reflected in their prospects within the single internal market: in Greece the expectation is that the traditional industrial structure will tend to ossify whereas Spain and Portugal are more likely to modernize their industrial structures.

For the Southern European countries in particular, the completion of the single market at the end of 1992 is a substantial challenge. As EC Commission surveys suggest,²⁵ the Community's three newest members can be expected to use the opportunities brought by the single market in different ways:

The pattern in Greece is expected to be one of inter-industry specialization, as the economy falls back upon those types of production where it already has a comparative advantage, i.e. mainly labour-intensive industries such as garments and footwear. However, the disadvantages of following this path are firstly that the expected growth in demand in these industries is low, and secondly that European suppliers are having to cope with increasing competition from the Third World. There are only two ways in which it might be possible to alleviate these disadvantages: one is that some production in more central EC locations might be moved out to new locations in the Southern European periphery, and the other route involves upgrading the quality of traditional products, as was done in Italy with fashion clothing and quality footwear.

Spain and Portugal are felt to have rather better prospects in the single market. The Commission's study identified potential for intra-industrial specialization in both countries. This means that the less developed countries no longer confine themselves to developing production in which they have comparative advantages, but also develop modern product lines in high-tech industries where demand growth is expanding strongly. Technology transfer and the qualification of human capital, often as result of increased direct foreign investment, may give a boost to development in Spain and Portugal. The risks in this type of development lie in the possibly resulting dualism of the economy, with rapid growth in modern industries where multinational companies are heavily involved and growth rates lagging behind in the traditional branches of industry. Ireland is a case in point here, and the difficulty is added to by the fact that Ireland's traditional industries have also had to cope with a high level of import penetration from the EC since its entry.

The impending single internal market again raises the question of the costs associated with liberalization: the prevailing view is that the costs of adjustment are heavier in the case of inter-industrial specialization than in that of an intra-industrial division of labour.²⁶ Among the reasons

²⁴ Cf. Heinz-Jürgen Axt: 2,7 Millionen fanatische Griechen? Oder warum 40% der Wähler noch immer Papandreu bevorzugen, in: Südosteuropa, Vol. 39, 1990, No. 2, pp. 119-136, esp. p. 129.

²⁵ EC Commission, op. cit., pp. 70 ff.

²⁶ Cf. Bela Balassa: The determinants of intra-industry specialization in United States trade in: Oxford Economic Papers, Vol. 38, No. 2, July 1986, pp. 220-233; Peter Krugman: Economic Integration in Europe: Conceptual Issues, in: Tommaso Padoa-Schioppa (ed.): Efficiency, Stability and Equity: A strategy for the evolution of the economic system of the European Community, Oxford 1987.

given for that view is that it is easier to reallocate factors of production within industries than among them.²⁷ If these suppositions were to be confirmed in reality, the prospects for Greece, with its rather ossified industrial structure, in the single internal market are likely to be worse than those of the Iberian countries, no small part of the reason being that it has not properly coped with the consequences of EC entry.

Polarization and Convergence

4. Does entry into the EC lead to polarization or to a closing of the development gap? The evidence discussed above does not allow a generalized answer to this question. Nevertheless, one view does appear plausible, namely that Portugal and Spain seem to have been closer to a path of convergence with the rest of the EC since 1986 than Greece, which has evidently been following a path of polarization since 1981.

General statements on this issue are hardly permissible given the relatively short period for which the three Southern European countries have been members of the Community. It cannot be ruled out that currently perceptible trends may at some time be reversed. Greece is certainly in a position to improve its situation by carrying out thorough structural reforms. So far that has not been the case, with Greece's position increasingly tending to deteriorate during the 1980s, whereas the Iberian countries made up a little ground on the EC average. This is demonstrated by the admittedly rather crude indicator of gross domestic product per head of population.

As shown in Table 1, Spain's position relative to the EC average had deteriorated between 1977 and 1985. After their entry into the EC, Spain and Portugal both showed a rising trend up to 1989. The same effect did not occur for Greece, however, for its position deteriorated steadily

when set against the EC average, and fell below the value for Portugal in 1989. It would indeed have been surprising, given the economic events in Greece discussed earlier, if the country's economy had not taken this course which makes it the Community's most difficult case at present.

Lessons for Eastern Europe

5. There are at least two lessons which those countries among the reforming economies of Eastern Europe which are hoping to join the EC might learn from the experience of the Community's new southern members. Firstly, and despite the substantial net transfer of EC funds to new member countries, the costs of liberalization that they would have to cope with should not be underestimated. Secondly, the EC's cohesion policy can only have a subsidiary effect, and help from the EC Commission cannot act as a substitute for effective economic policies in the member countries themselves which not only motivate domestic entrepreneurs but also attract investors from abroad. This is all the more valid for the Eastern European countries, which in contrast to the Southern European countries have yet to successfully transform their economies into market economies.

The EC is currently not only offering financial support and cooperative agreements to the Eastern European countries now undergoing transformation, but also has a new form of associate agreements, known as "European Agreements" under discussion. Indeed, some of the countries involved (Hungary, Poland and Czechoslovakia) are actually keen to become full members of the Community, though existing members believe this could only be considered for the next century, once the single internal market has been completed.

Apart from the direct financial benefits, a key motive for entering the EC as far as the Eastern European countries are concerned is the opening of current economic frontiers, especially as regards agricultural produce. However, the experience of Greece ought to have made it clear to these countries that they would also face liberalization costs, which might considerably exacerbate other negative developments if economic growth were insufficient and the extent of structural change inadequate. Even net financial transfers amounting to over 3% of GNP are not enough under such circumstances to help turn the economy around.

The national economic policy pursued by any particular country is crucial to whether liberalization effects will mean that economic problems begin to pile up or whether they will encourage an expanding economy and a narrowing of the development gap. Cohesion policy, to reiterate the point, can only exert a subsidiary effect.

Table 1

Per Capita GDP as Proportion of EC Average¹
(in %)

	1977	1985	1986	1987	1988	1989
Spain	78.6	71.8	72.2	74.0	74.9	75.8
Portugal	51.4	52.1	52.8	53.7	53.9	54.4
Greece	57.3	56.8	56.0	54.3	54.2	54.1

¹ At 1980 prices and purchasing-power parities.

Sources: Eurostat; Revue Rassegna 1977-1986, p. 38; EC Commission, op. cit., p. 71.

²⁷ It is said that redundant employees have an easier time finding new work when there is an intra-industrial division of labour. Moreover, growth resulting from intra-industrial specialization is generally regarded as having been responsible for the relatively unproblematic integration of the original members of the EC. Cf. Robert C. Hine, op. cit., p. 3.