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Europe tomorrow and the day after - the stage is being set today

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Europe tomorrow and the day after - the stage is being set today

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On January 1, 1993, the last remaining obstructions to the free movement of people, goods, services and capital between the states of the European Community are to be removed. This would substantially further the economic integration of Europe which began thirty years ago, and the largest market in the world, comprising more than 320 million consumers, would be created.

At the moment, this Europe is still being compared to a chaotic building site. Yet one thing is certain: the Single Market will produce more upheavals than its inhabitants can imagine today. It will transform industrial locations and modes of production, divert trade flows, and give rise to new services. Above all, though, it will shake established economic habits and thus have repercussions for the very fabric of society itself.

Given this background, the hopes and fears are not far removed from each other. On the one hand, there are the projected expectations of more growth, employment and wealth; on the other, the existential fears, the concern about losing one's regular job, and ultimately worries about the changes themselves. Consequently, public opinion as regards a frontier-free Europe vacillates between unthinking euphoria and deep-rooted scepticism. Both attitudes are equally unproductive.

What is needed is something quite different: bold vision and the ability to tackle problems in a sober fashion in all sections of society - politicians, entrepreneurs and all employees, in schools and in training institutions, in trade organizations and at the individual level.

For Europe is still under construction and by no means finished: in fact, its final political shape has not yet even reached the drawing-board stage. In other words, it can still be shaped and indeed has to be. In this respect, it is imperative that the edifice be provided with the proper, economically sound statics, so that it is in fact able to bear the hopes and the expectations placed in it. To ensure that this is so, clear ideas are needed about the market-economy framework, as is concentration on the essentials.

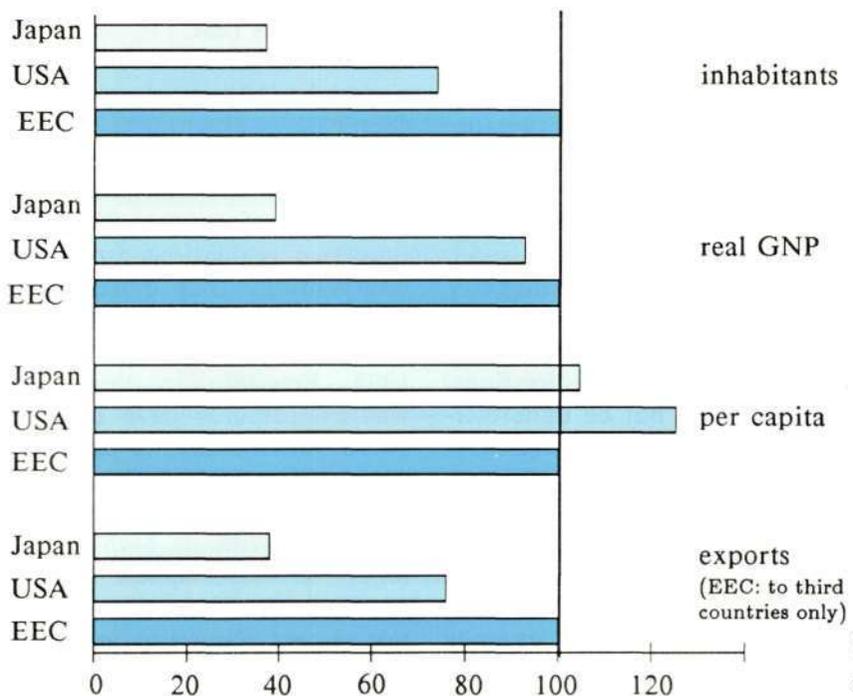
Paradoxically, the very flood of information at the moment on the topic of Europe has tended to blur rather than sharpen awareness of the all-important structural issues. It is all the more vital, therefore, to distinguish the essential from the inessential, to separate the ends

from the means, and to focus all efforts on those mainstays of the European edifice which will play a decisive role in the future of both Europe itself and that of its inhabitants.

Let competition flourish ...

The lasting success of the Single Market, and thus the opportunities for Europeans in a world that is quickly closing the gap, stand and fall with the economic order to which this market is subjected. The possible alternatives are easy to recognize: Europe will either turn into an entity run by a centralized administration, with uniform rules, regulations and standards, or it will develop into a Europe of competition, which is shaped to quite a considerable degree by its informed citizens

The economic blocs USA and Japan in comparison with EEC (1987, EEC=100)



Source: OECD, EEC Commission

through their market behaviour. Anyone familiar with the loss of efficiency and democratic procedures in an economic system controlled by bureaucrats has no choice but to favour an order based on competition. Here competition is meant in a really broad sense - as the prerequisite for and also the driving force behind a free society and as the necessary basis for a wealth-creating advance in productivity. One of the great tasks awaiting the social and political forces in the new Europe is systematically to open and to keep open the doors for this type of competition. Moreover, there is need to be constantly alert and resolute, for the process of "creative destruction" (Schumpeter) - that is inherent in all living things and consequently in economic bodies as well - which causes the old to die, and something new to emerge in its place, and which also raises a national economy to a higher level of maturity, has never functioned unopposed.

Wherever, either now or in the future, existing structures and industries, or traditional attitudes and modes of behaviour sense that they are threatened by this process, they will bring enormous pressure to bear on both the state and politicians to preserve the previous status quo - even if this runs counter to what the market wants and is at the expense of the general good.

These conservative forces, which feed on rational as well as irrational motives, should not be underestimated - and this applies even more so to the virtually unlimited forms of government intervention. The constant meddling with the market at the national level, with West Germany providing an especially unfortunate case through its stock of regulations and subsidies, are cautionary examples of government intervention in the market

relationship that exists between mature, independent citizens. This is underlined by the senseless waste of resources which occurs as a result to the detriment of all concerned. Unless it proves possible to bring about decentralized guidance rather than administrative control in the Single European Market, the latter will not be able to meet the expectations placed in it. The academic, business and political communities must all shoulder the permanent task of making these connections generally intelligible and, what is more, acceptable.

The future distribution of the gains - or losses - realized through the Single Market does not simply depend on the extent to which companies can adapt or on the qualifications and efforts put in by their workforce. What is decisive is the economic, social and structural setting. Of course, economic policy cannot stipulate that companies must be ready to adapt or that employees must be willing to put in more effort. Yet it does have to remove obstacles which impede both innovation and the readiness to give one's best.

... and limit harmonization by decree

Giving priority to competition means, therefore, that the present jungle of regulations and market interventions that exists in the various countries must be thinned out considerably with a view to 1993. Precisely in those areas where structures have been imposed bureaucratically up to now, structural adjustment has to be systematically encouraged. West Germany, with its high share of regulated markets, has a special need to make up the ground lost in this respect. Failure to do so would impair its credibility.

Giving priority to competition also

means that harmonizations by decree have to be relegated to the bottom of the list of priorities. No matter how great the temptation is for European bureaucracies to prescribe the same standards and guidelines for as many areas as possible, the underlying principle must be: as much leeway as possible, no more externally dictated convergence than necessary. Anyone who believes that, in some specific case, bureaucratic harmonization is required also bears the burden of proof - and not vice versa.

Market access, then, must primarily be guaranteed by the mutual recognition of national standards and rules. There is no need for an all-embracing harmonization of legal codes for this purpose, nor would such a step be desirable in terms of the independence of the market participants. Regardless of whether German spaghetti or Italian beer is the issue: as from 1993, the country-of-origin principle should guarantee access to the Single Market for all products that comply with the standards set by the ECC country in which the product was manufactured.

However, the toleration of national standards will in any case probably lead to a de facto convergence, because the standards which are judged by the buying public as a whole to be the most "consumer-friendly" will generally prevail. By contrast, commissions of experts are far less reliable judges of what standard is most appropriate for the Single Market. With their schematically imposed verdicts, they often hold development back at a level lower than would be either necessary in the interest of the consumer or possible if competition were given free rein.

Naturally, as the exception to the rule, it is advisable in certain fields

for the government to fix certain minimum norms. This is not so much in order to protect consumers who are unable to look after their own interests as to avoid damage caused, for instance, through contagious diseases, irresponsible treatment of the environment or threats to the communications system. Should the incentives provided by market-oriented principles not be sufficient, clear-cut, universally binding rules and liabilities must be established. Yet even in such cases, harmonization must not be used as an excuse for subordinating the community of national markets to a single European super-authority. It is not simply the case that the democratic legitimation for such a move is missing. After the experience gathered with European farms policy, there is also reason to fear that an authority equipped with far-reaching powers would suffocate the markets with a flood of regulations. But there is really no need at all for a new "market organization".

Priority for competition, removal of regulations and a prudent limitation of harmonization to the absolutely necessary - if it is to be effective, this basic line of approach must apply to all the components which make up the Single European Market, some of which will be mentioned in the following. First and foremost, though, both the obvious and the hidden obstacles to trade must be entirely abolished.

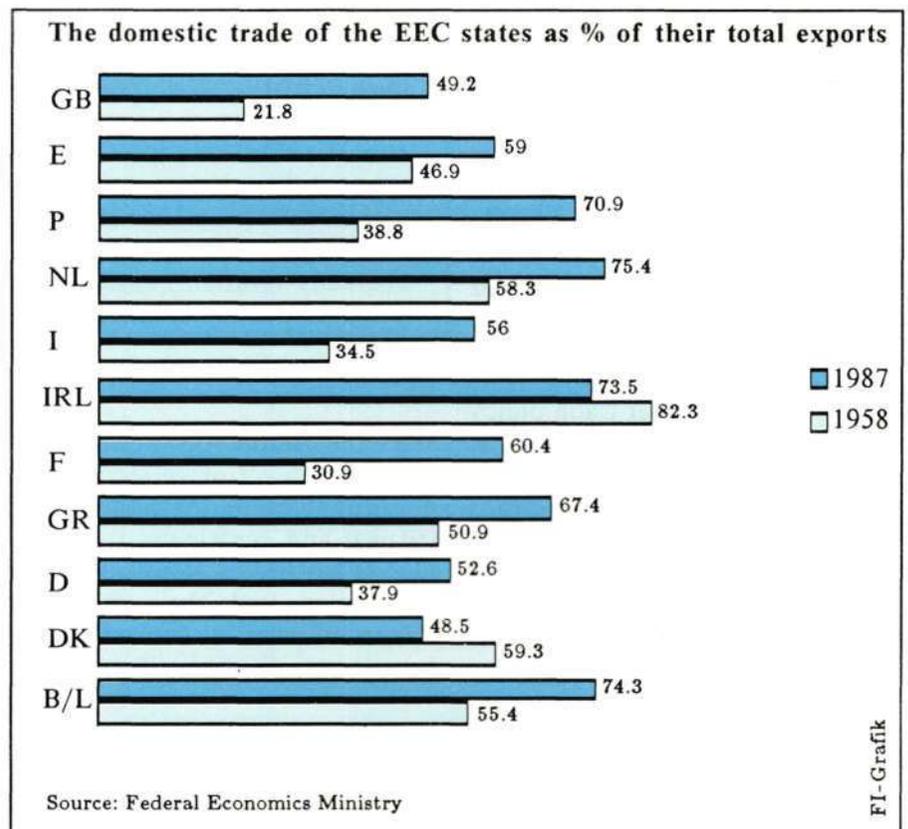
Demolish trade barriers

Although the intra-EEC trade of practically all memberstates has expanded considerably over the years (see chart), many kinds of trade barriers still exist between them. While internal duties have been abolished, they have frequently been replaced by other hindrances to trade.

It is claimed that such a development is justified by the demands of consumer safety, health considerations and environmental protection. However, as these measures differ quite strongly from member country to member country, they have highly protectionist effects. They frequently compel companies to develop and offer special products for isolated markets. The result is an inefficient fragmentation not only of production procedures but also of the purchasing and marketing systems. Further drawbacks are to be found in the necessity for larger inventories and the higher guarantee risks deriving from manufacturers' liability for their products. For this reason, many firms - and especially smaller businesses - restrict themselves to the confined national market. In either case, a loss occurs for which ultimately the consumer has to pay. In view of the multitude of national demands which are levelled at product design or manufactur-

ing procedures - in the industrial domain alone there are currently more than 100,000 divergent stipulations - the whole wealth of ideas hitherto directed into the invention of fresh obstacles to trade should in future be focused on removing them. The demolition of such non-tariff barriers lies at the heart of the EEC integration project.

But the unified domestic market not only requires the removal of material barriers in the form of border controls and the abolition of technical barriers in the form of national regulations. It also calls for all-out liberalization in virtually all areas of business - a point which can only be touched upon briefly here. For instance, the free flow of services at present is still substantially hampered by incompatible and complex systems of regulation at the national level. Capital movements as well are still restricted in the European Com-



munity. What is more, step by step, self-employed professional people must be permitted to set up shop anywhere within the EEC that they wish by virtue of the member countries mutually recognizing qualifications; similarly, the impediments to the mobility of employees must be removed through a mutual recognition of professional documents. Last but not least, one of the key features of the projected Single Market is the introduction of true competition into the field of public procurement. Not all of this can be realized by 1993. What is crucial, however, is that all the steps taken point in this direction.

Develop social order

Even in this area, which is important for the efficiency of the Single Market and for its internal climate, two opposing basic conceptions exist: on the one hand, competition between the various member states and their welfare provisions; on the other, harmonization of the labour and welfare legislation by means of a new law or a bureaucratic decree.

Each alternative has found its advocates since Europe has been discovered as a "social space". West German unions in particular, with the high social standards that have been attained here behind them, are keen that many of these are taken over by the rest of the Community - the list stretches from the system of collective bargaining itself to substantive stipulations on points of detail relating to working conditions. In order to prepare the ground for this, "solidarity" is called for. The double-edged nature of such argumentation already becomes evident from the fact that this kind of solidarity above all robs employees on the southern edge of the Community of their only trump cards: lower wage costs and a longer working week; consequently, it would force

large numbers of them out of their jobs.

For this reason, it must be in the interest of both employees and the Community itself that the social dimension, too, is imbued with the spirit of competition. As the single Market draws closer, every state must decide whether to take a critical look at its legislation on labour issues and collective bargaining and, if so, whether to prune it or extend it.

This need by no means lead to a removal of social privileges and established positions. After all, job-creating investment decisions are ultimately made in the light of the whole set of conditions which affect an industrial location, and these include the level of qualification attained by the available labour force just as much as the flexibility present in both the labour market and at the individual workplace, or the existing infrastructure and the stability of the social climate. The more favourable the overall conditions offered by a country in the competition over industrial sites, the more such a country and its employers and unions can allow themselves. However, it is one of the German illusions that, faced with the conditions created by the Single Market and, on top of this, in view of our country's ageing population structure, we believe that in the long run we can hold on to everything at the same time: high wages and salaries, sizable welfare benefits, ever more leisure time and cosy, uniform working hours.

In West Germany, as in all the other nations, the focus must be shifted back to the elementary connection between cause and effect, productivity and wealth. Only if productivity is raised can high incomes and social improvements be achieved, and these pre-

suppose more capital spending and a more flexible labour market. Incidentally, in the social domain as well, de facto harmonization will develop between the different countries, since those arrangements that are plainly better will prevail over others. Of course, in this domain too, competition cannot be given a free rein: there are areas in which minimum standards are necessary throughout the entire Community. This holds true above all for the non-product-related protection of jobs and product-related technical stipulations. Here the Community is already extremely active.

All in all, social policy in an internal market of some 320 million people will be quite different from what we in particular are used to in West Germany. The question will have to be raised again: what the real "social achievements" are, which their advocates claim - in a terminology that reveals their immobility - have to be firmly "anchored" throughout Europe. Moreover, given the differing values and habits in the various parts of Europe, the question is bound to receive quite different answers. Overall, this will lead to a fruitful reappraisal.

Let tax systems compete

In the field of taxation, competition has long since broken out between the states of Europe. Just how they adapt in detail to this competition should in principle remain their own concern - ultimately they have to justify all by themselves to their citizens their policy with regard to industrial locations. Consequently, there is no reason to demand an all-embracing harmonization of taxes. This applies especially to the type and level of company taxation. In recent years, most industrial nations have

drastically cut business taxes or plan such relief before the Single European Market becomes reality.

For West German companies, the competitive disadvantage which they already had in this respect is thereby aggravated. At present, the non-distributed profits of German incorporated firms are taxed at 70.8%; that is twice as high as the tax burden borne by British companies (cf. chart). It is true that as from January 1, 1990, thanks to the third phase of the tax reform (lowering corporate income tax to 50% from 56%) the tax on companies' retained profits will be brought down to 66.2%. Nevertheless, even after this, West Germany will continue to be the country with the highest corporate taxation load. If the Federal Republic is to preserve its chance of being a location for investment in the future, there is no alternative to harmonizing corporate taxation. Should this problem not be tackled in good time, capital outflows will prove a far more painful means of ensuring that it happens.

Whereas the validity of the country-of-origin principle is unchallenged as far as direct taxation is concerned, a centrally imposed harmonization is being sought for indirect taxes. With the exception of Greece, the EEC countries use the same system of value-added tax; however, their individual rates differ greatly. The standard rates alone range between 12% and 25%. The European Commission would like to see the standard rates for value-added tax levelled out to a range of 14% to 20%, with a compatible basis of assessment used. Reduced rates - above all for foodstuffs, energy and passenger traffic - should then vary between 4% and 9%. "Luxury" and zero rates would no longer be permitted. West Germany, with its two rates of 14% and 7%, would already lie

within the range which Brussels has outlined, while other countries would not only have to alter the rates of taxation, but they would also have to make substantial changes to their tax system. As it is extremely difficult to achieve consensus in this area, the country-of-origin principle should be valid here as well. Since value-added tax is refunded when goods are exported and added to their price when they are imported, many people - including the European Commission - believe that value-added taxation rates have to be brought into line with each other if customs controls are to be abolished. Yet it remains to be seen whether this is the case and to what extent differences in the level of value-added tax rates are automatically offset by exchange-rate adjustments.

Fortress not the proper goal

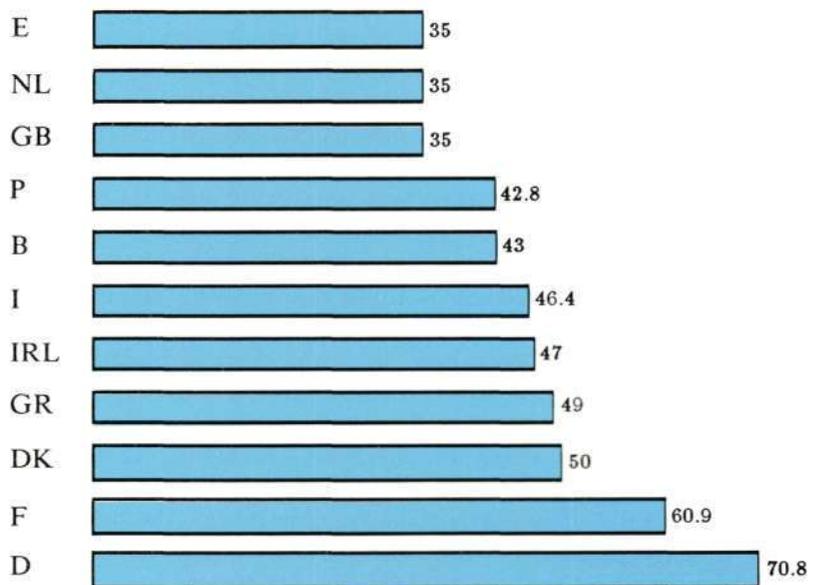
Ultimately, competition within the Community must be complement-

ed by competition with the outside world. The "fortification" of Europe which is intended to be achieved through the removal of material, technical and tax hurdles must not be allowed to turn into the construction of a "Fortress Europe" - as third countries, and especially our important trading partner the USA, fear.

The concern shown by these countries cannot simply be brushed aside. For one thing, substantial impediments to trade exist in those very areas where a common market already exists - in the coal and steel sectors and in farm produce. For another, a closer look reveals that the community members have developed an entire arsenal of protectionist practices, which does not suggest a very liberal approach.

Once the Single Market is completed, the temptation to apply these instruments will become even stronger. Faced with keener com-

Tax burden on non-distributed profits of an incorporated company as % of taxable earnings (as of January 1, 1989)



Source: Institut der deutschen Wirtschaft

FI-Grafik

petition inside the Community, the worried pressure groups will do all they can to alleviate the burden on them by sealing their market off from the outside world. In such a case the danger is especially great that the reciprocity principle will govern trade relations with third countries. This would mean that imports from one country receive the same treatment as EEC imports to that country. Application of the reciprocity principle would further strengthen the Community's already solid external defences. If this happened, the damage done would not be to third-country rivals alone; it would also affect consumers and firms within the Community, which would be obliged to pay excessively high prices for protected products. The more the Single Market is shielded from foreign competition, the weaker the pressure on companies to hold their own against highly efficient suppliers from Japan, the USA and the newly industrializing countries through innovation in their products and manufacturing procedures. This would automatically lead to a slowdown in Europe's economic growth. At the same time, the danger would arise that the economic power of the large firms and the merged companies would remain unchecked and could easily be abused. What the Community needs, therefore, is a liberal conception for its trade policy.

Incidentally, a liberal trade policy has always been the best policy as regards competition and is at the same time the most effective means for combatting institutional and structural fossilization as a result of government concessions and interventions.

Conclusion:

- As yet, there is no fixed plan which lays down what the projected Single Market will eventually look like. The future Europe is being created today.
- Two clashing conceptions exist: a Europe bound up in regulations with few incentives and opportunities for development, or a Europe of competition, which releases new forces for tackling its future-oriented tasks.
- We still have the chance to create a Europe of the latter kind. However, once the downhill path of political intervention in the markets and recourse to regulations is taken, there can be no return to a liberal approach.
- In dealing with the intensifying competition between regions and sectors, the Government in Bonn, for its part, needs to return to the policy stance which once created the impressive "social market economy" system. To this end, the Government must now systematically pursue a course of deregulation, flexibility and lightening the company taxation burden.

Outlook

Since the Middle Ages, Europe has been the object of reflection and political struggle, the hub of centrifugal and centripetal forces alike. It has been synonymous with destruction and the subsequent efforts to rebuild. Currently, the

continent is attempting to find a new form and a new content as well. This will be a long drawn-out process, which is preceded by economic convergence, although not exhausted by the latter.

The momentous task is - while preserving European variety - to create an area whose inhabitants understand each other and pool their various energies and talents. This will lead to an improvement in the conditions under which all the inhabitants of this region live; it will broaden their intellectual horizon and mean that the global challenges facing present and future generations - and here above all the preservation of an environment conducive to human existence - can be coped with more successfully.

The best basis for achieving these aims is to let the notion of competition become a guiding principle for the economic and social order. Competition, rather than regimentation, from the Atlantic to the Aegean, is in any case more in keeping with the traditional self-understanding of the European democracies and is a sign of a healthy self-confidence.

What is necessary now is that all the social forces in all the states of the Community - whether in the political arena, business, the academic world or in the form of alert citizens - do not simply allow developments to take their own course, but rather they should make a joint effort to steer developments in the direction of the common goal. Europe tomorrow will be what we Europeans make out of it today.