£3 Billion

THE PRICE WE PAY FOR FLYING THE FLAG IN BRUSSELS

PRIME Minister Callaghan's "five-point plan" for world economic recovery will feature prominently in the news in coming months. It will be the main item on the agenda of the Common Market summit meeting in July when specific proposals—now being worked out—for a "common economic strategy" are to be debated.

The five key topics are faster growth, stable money, energy, trade and capital movements. A target of a $4\frac{1}{2}\%$ growth rate for Western Europe has already been agreed upon, but there are doubts whether this can be achieved unless fluctuations in the exchange rates between European currencies can be controlled. So we may expect to hear more of Roy Jenkins' recent proposals for European Monetary Union (EMU).[1] This, as Roy Jenkins has said, would involve "a significant transfer of power from member governments to the Community," as well as vastly increased contributions to the Community budget.

All of this may seem rather odd to anyone who remembers the letter which Mr. Callaghan wrote to the Secretary General of the Labour Party last October about the need for EEC reform. Then he stressed the need to maintain the authority of national governments and to enable them "to pursue their own economic, industrial and regional objectives". In common with the five-point plan, the letter referred to a community energy policy but unlike the five-point plan, it emphasised the need to reform the Common Agricultural Policy and to bring Community agricultural prices more nearly into line with world prices.

What has happened to change matters? Have Community prices in fact moved into line with world prices? Not according to economists at Cambridge's Department of Applied Economics. By their estimates,[2] Community prices are above world prices by amounts varying from 25% for wheat to 81% for butter; as a result of which Britain is paying an extra £330m. a year for its imports. Adding in our net contribution to the Community budget—estimated at £660m.—we are thus subsidising the Community to the tune of about £1,000 million a year. Assuming that the growth of the UK economy is constrained by the balance of payments, this, the Cambridge economists estimate, means that national income is being reduced by about £3 billion a year (or about 3%) as a result of membership. Nor are matters likely to improve; on the contrary, there is pressure for further price increases resulting from devaluation of the so-called "green pound" (beyond the $7\frac{1}{2}\%$ devaluation already agreed).

BY JOHN GREEN

Mr. Callaghan's change of attitude toward the EEC can hardly be attributed to the benefits which we are now getting from membership. It is more likely to have stemmed from a growing realisation of the powerlessness of Keynesian demand management policies to solve our unemployment problem. The tax cuts in the April budget are expected to stimulate consumption and therefore imports, but the prospects for a corresponding growth of exports are poor, partly because of the remarkably depressed state of world trade (the budget statement notes that the GNP of the OECD countries grew by $3\frac{1}{2}\%$ and that—unusually—world trade in manufactures grew by only the same percentage). Under these circumstances the Chancellor dared not cut taxes further for fear of precipitating a big balance of payments deficit and another run on the pound such as happened in 1976. The irony is that Mr. Healey's opposite numbers in many other countries feel themselves under a similar constraint, each fearing a trade deficit with the others. These fears could be allayed, Mr. Callaghan argues, if the EEC took concerted action to stimulate growth. They would then enjoy the relative safety of what has been termed the "convoy effect". (If, on the other hand, they all turned in desperation to the remedies for unemployment which have been urged upon Mr. Healey by the English economists of the "New Cambridge School"—import controls and employment subsidies—the constraints would tighten and the prospects of recovery would recede.)

The Government evidently sees some prospect of concerted action, and this was clearly behind the optimistic references by Treasury Ministers to the possibility of further tax cuts in July.

The alarmed reaction of the City at the time to the hint of further tax cuts was a reminder that the balance of payments is not the only constraint which the Chancellor has to consider. The City could not see how a bigger budget deficit could be financed without further increasing the money supply. Finance Ministers in other countries also have to watch their money supply figures; and in Germany in particular, the fear of accelerating inflation is a strong influence on economic policy. This may explain why, after being at first rather sceptical about Roy Jenkins' proposals, Chancellor Schmidt is now reported to be a protagonist of monetary union. He and President Giscard are said to want the EEC to create a new zone of monetary stability by including the pound, the lira and the French franc in a new enlarged currency "snake", floating jointly against the dollar.

Whatever the advantages of monetary union for price stability, it certainly would not be consistent with allowing national governments to "pursue their own economic, industrial and regional objectives." With the exchange rate placed beyond the control of a national government, a persistent balance of payments deficit could no longer be corrected by devaluation. It might be corrected by differential wage movements, but if this did not happen, it might lead to increased unemployment and eventually to migration. The UK might find itself standing in the same relations to the rest of the EEC as Scotland and Northern Ireland have stood in relation to England. This is recognised as being politically unacceptable, which is why Roy Jenkins reckons that the Community budget would have to be increased by four to six times its present level, mostly to finance regional subsidies. The amount of financial assistance to be given to those parts of the UK which are dominated by declining industries would ultimately become a matter for the Community to decide, and not the British Government. The signs are that Mr. Callaghan does not relish this prospect, but he is likely to find that some move toward it is part of the price which will have to be paid for action on the part of West Germany to put more priority on raising its growth rate. Another part will be the freeing of the remaining exchange controls which at present restrict UK investment in the Community —and here again the fear will be that capital as well as labour may tend to migrate toward the prosperity of Europe's "golden triangle."

Whether closer integration with Europe, through the five-point plan or otherwise, would benefit the people of this country depends very much upon the way in which the Community is to develop. The sacrifices of political sovereignty could be considerable, and there is little sign from the polls of popular enthusiasm for such sacrifices. But on the economic front, the immediate sacrifices may be more apparent than real. The record of Keynesian demand management in the UK leaves plenty of room for doubt as to whether it has really had a stabilising influence. Devaluation as an instrument of policy turns out to have yielded benefits which at best are transitory.[3] And UK regional policy may well have delayed modernisation without doing much to reduce local unemployment.

If Community economic management were more ponderous and less responsive to political pressures, this might in the long run be no bad thing. The dynamic effects upon the UK economy resulting from increased competition and from free access to the Community's markets, which were envisaged at the time of entry, have been slow to develop, but this may have been the fault of OPEC. Formal tariff barriers between the UK and other members have now been abolished and the Commission have been active in outlawing barriers to competition erected by private firms. But there are still many signs of a desire on the part of member governments to restrict competition for political or nationalistic motives. Agriculture is by no means the only sacred cow to be protected in this way, and British governments have been far from blameless (one has only to think of the heavily subsidised Polish shipbuilding deal). On the continent, the massive subsidies which the German government say they have been putting into the Airbus project—matched presumably by similar though undisclosed action by the French—are but a symptom of a broader policy of limiting competition. The Community has a good way to go to achieve the objective set out in Article 3 of the Treaty of Rome of eliminating customs duties and quotas between member states *and of all other measures having equivalent effect*.

> 'Competition is the best stimulant of economic activity since it guarantees the widest possible freedom of action to all. An active competition policy pursued in accordance with the provisions of the Treaties establishing the Communities makes it easier for the supply and demand structures continually to adjust to technological development. Through the interplay of decentralised decision-making machinery, competition enables enterprises continuously to improve their efficiency, which is the **sine qua non** for a steady improvement in living standards and employment prospects within the countries of the Community.'
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> —EEC Commission: First Report On Competition Policy, 1972.

But it is the development of the Community's relations with the outside world which should give the greatest cause for concern. Its Common External Tariff averages six per cent, which is arguably modest, but this is not a true measure or the extent of protection. Community ministers have been actively trying to restrict outside competition by bargaining, persuasion and threats. Their unseemly dealings with the Japanese government have reached public attention largely because of their lack of success. Similar deals with other countries have tended to pass unnoticed.

If the main motive for closer integration should turn out to be merely to give Common Market ministers more "muscle" in their dealings with the US, Japan and other competitors, then the eventual prospects for world trade and recovery of the UK economy could be bleak. Sceptics may in any case doubt whether fundamental problems can be solved merely by transferring them to different institutions, and will regard Mr. Callaghan's move as a digression from the task of putting matters right at home.

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1. 'The case for EMU', **European Community,** March 1978.
2. The direct costs to Britain of belonging to the EEC', **Economic Policy Review,** Cambridge, March 1978.
3. 'Some effects of Exchange Rate Changes', Treasury's **Economic Progress Report,** March 1978.