

THE ECONOMICS
OF 1992
A SYMPOSIUM ON SECTORAL ISSUES

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A SYMPOSIUM ON SECTORAL ISSUES*

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BACKGROUND TO THE SYMPOSIUM

JOHN BRADLEY

The symposium on *The Economics of 1992: A Symposium on Sectoral Issues* held in the ESRI on December 1, 1988, had as its focus the investigation of some of the main avenues through which the process of completing the internal European market (or "1992") will impinge on the Irish economy. Three papers were presented at the symposium, dealing with manufacturing industry, with the distribution subsector of services and with agriculture.

Public debate about the 1992 process received a great impetus from the publication in 1988 of the Cecchini Report (Cecchini, 1988). This report was designed to be accessible to a wide audience and, although upbeat and positive in tone, made clear that the benefits of market completion would not drop into our laps unaided by any extra effort on our part. These benefits would have to be worked for through the detailed enacting of the legislative programme of the White Paper on the Single European Act.

Behind the very readable and anecdotal Cecchini Report lay an immense body of solid economic research, much of a pathbreaking and innovative kind. Under the chairmanship of Paolo Cecchini, a group of EC researchers, aided by outside consultants, had laboured for about two years in an effort to quantify the costs to its citizens' welfare of the fragmentation of the European marketplace and the possible benefits of removing this fragmentation by dismantling all the remaining barriers to trade within Europe. A more comprehensive presentation of the main technical analysis is assembled in Emerson *et al*, (1988), and detailed technical results are available in a wide-ranging series of working papers issued by DG II, the EC Directorate-General responsible for Economic and Financial Affairs.

Given the ambitious nature of the 1992 project and the immense ground to be covered, the Cecchini Report was bound to stir up public debate and controversy. Of its two components, the first (i.e., quantifying the costs of "non-Europe") was the more straightforward. Most citizens of the EC, both as consumers and producers, have had first hand acquaintance with the difficulties of doing business across national frontiers. The delays and costs of red-tape and border-related controls are the bane of importers' and exporters'

lives. The restrictive procurement policies pursued by national governments both reduce competition and ensure that many strategic European industries are below optimal size. Divergences in technical regulations and standards cause similar effects. Barriers to the cross-border supply of services (particularly financial services) result in European consumers paying higher prices than would prevail in an open and more competitive market place.

The second component of the Cecchini Report was more controversial. Here an attempt was made to estimate the benefits that would emerge for the EC economy as a whole after all trade barriers are eliminated. Two different but complementary approaches were used. In the first, the microeconomic approach, the impact of removing non-tariff barriers on companies, consumers and governments was studied in order to establish the general benefits that would accrue to them. In the second, the macroeconomic approach, the effects on the main macroeconomic aggregates were analysed (e.g., GNP, inflation, balance of payments, government deficits, unemployment).

The micro and macroeconomic approaches were used to study mainly the seven larger EC members (Germany, France, Italy, the Benelux and the United Kingdom) which together account for 88 per cent of GDP of the EC twelve. The aggregate effects on the remaining five members (Denmark, Greece, Ireland, Portugal and Spain) were assumed by Cecchini to be proportional to their share of GDP in the EC twelve. In broad terms, the 1992 process was estimated to boost total EC GDP by between 4 and 7 per cent over what it would have been in the complete absence of the abolition of non-tariff barriers. This extra growth was shown to be accompanied by a lower rate of price inflation, higher employment (after an initial fall due to job shedding in the early years), lower government deficits and improved international balance of payments.

The issue of how these benefits would be shared between the different member states was not addressed by Cecchini. Given Ireland's peripheral location in the EC, our late industrialisation, the foreign dominance of our manufacturing industry sector and our generally lower standard of living, it would be unwise to assume that we would automatically rise with the flooding tide of EC market completion. Indeed, although the Cecchini Report arrives at a generally positive conclusion concerning the 1992 process, its publication should also be seen as an open invitation for the individual EC members, in particular the "five" mentioned above, to study the effects on their own economies in greater detail than was possible in the initial report.

The ESRI symposium should be seen as part of this process of more intensive study. The paper by Dr Rory O'Donnell examines the impact of

1992 on the Irish manufacturing sector. In addition to providing material on the framework used to study the benefits and costs to Irish industry of non-tariff barrier removal, he provided a very detailed overview of how the component subsectors of Irish industry are likely to be affected. He concludes that, due to the great openness of the Irish economy, few parts of industry are still protected by non-tariff barriers. Indeed, in several sectors the dominant threats and opportunities will be those created by the technical and organisational changes which will accompany 1992 rather than by the actual removal of non-tariff barriers. He examines how these threats and opportunities are likely to affect individual industries.

The paper by John Fitz Gerald examines the implications of 1992 for the distribution subsector of marketed services, in particular its effects on pricing and sale of goods by manufacturers, importers, wholesalers and retailers. He highlights two main preconditions for a smooth transition to the post-1992 market: the harmonisation of taxes, particularly with the UK, and a competition policy which will ensure that Irish consumers will be able to enjoy fully the beneficial aspects of EC market completion. The importing/distribution element of the distribution sector is likely to suffer rationalisation and job losses although the possibility of Ireland, North and South, being treated as a single unit for distribution purposes may give rise to some opportunities for growth.

Finally, the paper by Alan Matthews examines the effects of 1992 on the agricultural and food sectors. He focuses on the effects of removal of non-tariff barriers in the food industries, the likely effects of 1992 on the system of MCA payments and on quotas, restructuring in the food industry and rural development and the use of the Structural Funds. Although declining in importance over time (in terms of its share of total exports and employment), the fate of the agricultural sector and related sectors will crucially influence Irish growth prospects over the next decade.

All three papers had formal discussants: Mr Terry Larkin on Rory O'Donnell's paper; Mr Tom Toner on John Fitz Gerald's paper, and Dr Miceal Ross on Alan Mathew's paper. The capacity attendance at the ESRI symposium and the wide-ranging discussion which followed the delivery of the papers were testimonies both to the excellence of the speakers and the formal discussants and to the deep general interest in the subject matter. The publication of the papers, in revised form, provides a permanent record of the symposium proceedings.

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MANUFACTURING

RORY O'DONNELL*

1. Introduction

Manufacturing industry in Ireland has already experienced the removal of tariff protection and tariff-free access to the markets of the European Community. The completion of the internal market by 1992 is intended to remove the many non-tariff barriers to trade, and to the movement of capital and labour, which remain in the Community. This paper suggests one way in which the likely impact of the removal of non-tariff barriers (NTBs) might be analysed. Such analysis is vital if successful policy, corporate, and individual responses to the threats and opportunities are to be devised.

The first requirement for an analysis of the effects of completion of the internal market is identification of how economic integration works. Section 2 provides this by identifying the processes of integration as envisaged in recent research on international trade. In Section 3 these concepts are used to devise a framework for a sectoral analysis of the impact of internal market completion on manufacturing industry. Finally, in Section 4 this framework is applied to manufacturing industry in Ireland. It is applied first to three broad categories of manufacturing industry and then to selected individual sectors.

2. Identifying the Processes of Integration

In order to identify the processes which economic integration sets in train it is necessary to consider the theory of international trade and integration. In recent years there has been considerable change in the theories of trade and integration and it is desirable that new as well as traditional approaches be taken into account.

* The author is a member of the Secretariat of The National Economic and Social Council. The views expressed in this article are those of the author and do not necessarily represent those of the Council. The NESC is, at the request of the Taoiseach, undertaking a major study on Ireland and the European Community. The study will include an assessment of the impact on Ireland of membership of the Community. It will assess the threats and opportunities inherent in the completion of the internal market and suggest policy measures, at both the national and Community level, which would help Ireland to make the most of its membership of the Community. In addition, the report will outline a strategic approach which Ireland should adopt to further European economic integration. Work on this project is almost complete and the report should be available in the near future.

The traditional approach to analysing international trade can be summarised very briefly as follows. International trade will cause each country to specialise in those activities in which its natural resource and capital endowment give it a comparative advantage. The classic textbook example is that a country with a relative abundance of labour will tend to specialise in and export labour intensive goods, while a country with a relative abundance of capital will produce and export capital intensive goods. This *inter-industry* specialisation will give rise to what is known as *inter-industry* trade: the traditional theory predicts that countries will trade very different products with each other. The gains from trade arise precisely because of the differences in the land, labour and capital endowments of the various countries.

Rather than discuss at length the *way* in which this theory has been changed in recent years it may be more fruitful to indicate *why* this has occurred. One reason is that some of its key predictions have not been fully confirmed in practice.

In studies of the effects of European economic integration, three developments are widely reported.

- (i) The growth of trade between members of the EC has mainly entailed specialisation *within* industries rather than *between* them. For example, instead of one or two countries specialising in steel production and others being forced out of it, each country has specialised in particular products and processes within the steel industry, and these are then traded between member states. Such trade is known as *intra-industry* trade, (see, Greenaway and Milner, 1986; Pelkmans, 1984).
- (ii) The increase in trade consequent upon the formation of the EC has coincided with a process in which large producers have pushed out smaller ones. This concentration of industry into larger production units and firms has been observed in several EC countries (see Owen, 1983; Muller and Owen, 1985; Pelkmans, 1984).
- (iii) Instead of being based on relative factor endowments comparative advantage in international trade is based to a considerable extent on technological superiority and innovation (OECD, 1987).

Much of the recent economic analysis of integration is motivated by the need to explain these three phenomena.

The explanations which have emerged lay great stress on *economies of scale*. Economies of scale are said to exist when cost of production falls as output is increased. Such falling costs of production are widely believed to exist, especially in manufacturing, but were excluded by assumption in the traditional approach to international trade. One of the most significant implications of the presence of economies of scale is that the potential gains

from integration are greatly increased since, a larger market allows substantial cost reductions, and at the same time makes it possible for a wider variety of goods to be produced — both of which increase consumers welfare. However, it has now been realised that allowing for technical economies of scale only provides some idea of the *maximum potential* gains from trade. The actual processes which are set in train by the removal of tariff or non-tariff barriers may be complex and varied. The reason for this is that where economies of scale exist the industry in question cannot be perfectly competitive. In the limit one would expect an industry in which there are continuous economies of scale to end up being monopolised by a single firm. In any case the presence of even moderate increasing returns implies that a number of firms in an industry have some market power, and this in turn implies that in analysing the effect of integration, or other policy measures, attention must be given to the *industrial structure*. We state, without detailed explanation, that the presence of increasing returns to scale and industrial structures explains the possibility of *intra-industry trade* — a phenomenon ruled out by assumption in the traditional analysis of integration, in which trade arises purely as a result of inter-industry specialisation of each country. Economies of scale and intra-industry trade have in turn been linked to the phenomenon of *product differentiation* (see Greenaway and Milner, 1986). For example, one obvious way in which increasing returns could stimulate intra-industry trade is the case where producers in relatively small countries can only reap economies of scale by concentrating on highly differentiated varieties of a given product. Each producer can only sustain the efficient scale of production by relying on the foreign as well as the domestic market.

The four phenomena, *economies of scale*, *industrial structures*, *intra-industry trade*, and *product differentiation* are linked in ways which allow for a very wide variety of outcomes from the integration process. One of the most important differences between the new trade theory and the traditional approach is that theory cannot be used to yield very general predictions about the effects of reducing tariff or non-tariff barriers. The actual outcomes depend on the very detailed conditions prevailing in each industry, and indeed, firm, and may also depend on the history of industry in each country (Venables and Smith, 1986).

In addition to allowing us to explain why so much international trade is in very similar goods (intra-industry trade) the new approach to trade offers an explanation for the observed increase in the concentration of industry into larger production units and firms in most EC countries. Drawing on the fact that there are dispersions of the sizes of firms in each industry Owen (1983) derives a logical explanation for increased concentration as trade barriers are reduced. The argument is based on the options facing the larger, and therefore low-cost, producers in increasing returns industries before and after the

formation of the customs union. What Owen shows is that with access to foreign markets provided by the formation of the customs union, the returns to driving out marginal producers by increasing capacity, and thereby lowering cost, are significantly increased. One important implication of Owen's approach, and one which seems to be confirmed by his study of trade in the European car, truck, and white goods industries, is that relative costs become *more* and not less significant as integration proceeds — even where non-price aspects of competitiveness are important.

The new approaches to analysing trade are also capable of explaining why so much international trade is based on technological competition. They do this by assigning an important role to economies of scale, advantages of experience, innovation and product differentiation as explanations of trade patterns (Krugman, 1983; 1987a; Brander, 1987).

While the potential benefits from trade are greater in a world in which economies of scale exist, one of the most important implications of the new trade theory is that the gains from trade are less certain and are likely to be unevenly distributed, (Krugman, 1987b; Eaton, 1987; Brander, 1987; Padoa-Schioppa, 1987). Krugman, one of the major authors of the new trade theory, says "theoretical models of strategic trade policy show that in industries subject to increasing returns, the size of the domestic market can be an important determinant of export performance" (Krugman, 1987b).

In undertaking a study of Ireland in the EC at the National Economic and Social Council (NESC) we have drawn on these theories in formulating a framework for analysis of the effects of market completion on the Irish economy. The framework we devised was similar in many respects to that which was subsequently used in what has become known as the "Cecchini Report", (*The Economics of 1992*, Emerson *et al.*, 1983). Consequently, we propose to use the framework found in the "Cecchini Report" in considering the possible effects of market completion on manufacturing industry in Ireland.

3. *A Framework for a Sectoral Analysis of the Impact of Internal Market Completion on Manufacturing Industry*

3.1 *Direct Effects of Market Completion*

Completion of the internal market will have both direct and indirect effects. Indeed, two distinct *direct* effects can be identified.

1 *Cost reduction* resulting from removal of non-tariff barriers (NTBs). For example, firms should be able to find cheaper inputs, transport and insurance; packaging and labelling costs should fall, the cost of goods traded should be reduced by the removal of bureaucratic obstacles, etc. These cost reductions

should facilitate price reductions and, consequently, increased demand and output.

2 *Increased competition* will result from the improved market access of firms in all countries. Firms which can currently operate high price-cost margins or price discrimination should find this ability curtailed by increased competition.

The relative strength of these two direct effects will differ from industry to industry. It is, however, possible to identify some of the factors which determine the strength of the two direct effects.

1 *Direct cost reduction* The extent of immediate cost reduction clearly depends on the height of NTBs in different industries. Some NTBs affect all industries which produce tradable products — the most obvious example being customs costs. Others affect only some industries — for example, national packaging, labelling or technical standards and national government procurement practices. But even when a NTB has an effect it will not affect all industries equally. For example, costs arising from customs delays or restrictive transport practices will affect products with low value to weight ratios disproportionately. It is agreed that in general NTBs are relatively less in low-technology products than in high-technology markets. But customs delays or road transport quotas may impose a much greater cost penalty on low-technology products, since they will be a higher proportion of the value of the product. The proportion of output which is currently traded is clearly an important determinant of the extent of cost reduction and should be referred to in assessing the probable immediate impact of completion of the market. Likewise, the frequency and height of non-tariff barriers will differ between intermediate and final goods and will depend in part on the nature of the relationship between the exporting and importing firm. For an evaluation of the significance of NTBs in the different industries see the supplementary volumes produced as background to the "Cecchini Report" (*Research on the "cost of Non-Europe" — Basic Findings*, Volume 1, and the summary in Part C of *The Economics of 1992*, Emerson *et al.*, 1988).

2 *Price reductions* resulting directly from increased competition are a function of the current degree of concentration of an industry. Despite the presence of NTBs, many industries still contain a considerable number of firms and, therefore, competition ensures that price cannot depart excessively from costs (inclusive of those arising from NTBs). Examples cited in the Cecchini Report include textiles, clothing, and footwear. By contrast, other industries are highly concentrated, and firms in individual national markets have scope for monopoly pricing, price discrimination, and

x-inefficiencies.¹ Examples are pharmaceuticals, man-made fibres, office machinery, domestic electrical appliances and motor vehicles.²

3.2 *Indirect Effects of Market Completion*

These two direct effects may be the start of two chains of causation which create substantial *indirect* effects. These have been labelled "size" and "competition" in the Cecchini Report and are depicted schematically in Figure 1.

1. *Market Size*: The *direct* effect of removal of NTBs will be to reduce costs and, consequently, price. As the quantity demanded and supplied increases, the firm may find costs of production falling again because of *economies of scale*. This facilitates further price reductions and output growth. But this is not the end of the indirect effects. The process of increasing output and exploiting economies of scale involves larger, low-cost, producers eliminating smaller high-cost firms and can, consequently, initiate a major restructuring of industry. This is one very important possible indirect effect of market completion.

But this may, in turn, stimulate further indirect effects which considerably alter the competitive environment for Irish firms. Firms which find themselves threatened by the low cost of the dominant producers will presumably search for counter strategies, such as product differentiation, product innovation, process innovation and mergers or take-overs. Besides posing new challenges, most of these strategies still imply "a slow but steady reorganisation of industry towards large-scale production with weeding out of fringe producers" (Pelkmans, 1984, p. 79).

How important will this indirect effect be and how will it influence firms in Ireland?

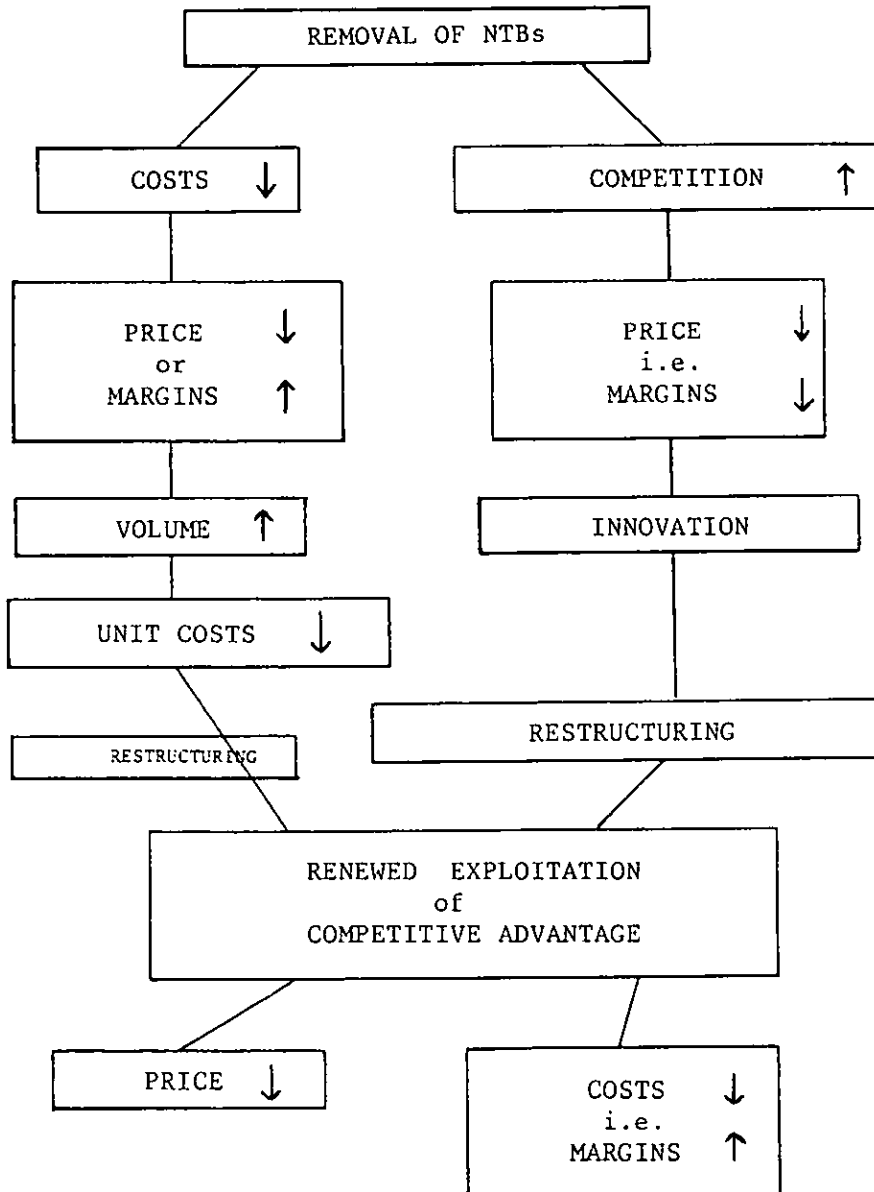
A major restructuring of industry with further growth in firm size depends first and foremost on the extent of economies of scale and the degree to which firms in the EC are currently below the minimum efficient scale. In assessing this for any given industry it is important to distinguish between:

- economies of scale in production;
- economies of scale in distribution;
- economies of scale in financing;
- economies of scale in R & D;
- economies of scale in innovation;
- cost reductions due to experience and learning.

1 Where total costs of production are not minimised, due particularly to monopoly power, the resulting poor performance is labelled x-inefficiency.

2 For further details see Part C, Part D.7, and Part D.9 of *The Economics of 1992*, Emerson *et al.*, 1988, and *Basic Findings*, Volume 1.

Figure 1: Schematic presentation of the two channels of direct and indirect effects of market completion



It is fairly widely agreed that economies of scale in these activities differ considerably (Pratten, 1988). For example, in many industries there are large economies of scale in production. Recent developments seem to reveal considerable scale economies in distribution but little or none in the innovation process (Emerson *et al.*, 1988; Geroski, 1988). It follows that the overall importance of economies of scale and, consequently, the extent of restructuring, will depend in large part on which activity is important in a given industry as a given time.

The size of economies of scale will determine what kinds of firms will reap the greatest medium to long-term benefit from completion of the European market, and also what kinds of firms will emerge in Europe after completion of the market. If economies of scale, of whatever sort, are very substantial, then larger firms will have an initial advantage and very large firms will ultimately emerge. If economies of scale are not so significant then small to medium-size enterprises (SMEs) will benefit and competition will take some other form than scale-based cost reduction.

This framework identified the questions which arise in analysing this first path of direct and indirect effects. These are questions which should be asked of each sector of manufacturing and services. The key question clearly is: are there economies of scale (EOS) in the industry? We ultimately wish to determine whether the *key* competitive advantage is scale or some other property such as: access to natural resources, labour intensity, product differentiation or the application of scientific knowledge. Clearly there are many industries where product differentiation or scientific application, rather than scale, is the *key* competitive advantage but where *some* economies of scale still exist. If some of these economies of scale remain unexploited in the European market then we can expect an increase in firm size as a result of larger firms eliminating smaller ones. Therefore, the question of scale economies should not be considered as relevant only to industries where scale or mass production is the *main* source of competitive advantage.

2. *Competition*: The direct effect which increased *competition* has on price-cost margins may be expected to stimulate two indirect effects of possible significance. The first is an increase in the internal economic efficiency of firms; the second is a spur to innovation.

Where some degree of monopoly power exists, then total costs of production may not be minimised or, put another way, more inputs are being used than is really necessary to achieve the given output. This waste or poor performance is known in economics as "x-inefficiency". Sharper competition can bring about the removal of these "x-inefficiencies". It should be noted that these inefficiencies arise not only from slack in production process but also from the use of inefficient decision-making practices. Consequently, their removal can

involve substantial rationalisation of an enterprise.

A view emerging from some recent work on industrial economics is that increased competition will have a positive impact on technical progress and the diffusion of innovation. This is at variance with a traditional idea that monopoly, despite its attendant costs, was more conducive to R & D and innovation. The new view denies that large firm *size* is conducive to innovation and argues instead that rapid market *growth* strongly stimulates innovation in industry (Geroski, 1988). This view leads to the expectation that completion of the market, by increasing competition, will have a major dynamic impact on those sectors in which current NTBs are high, technological development is significant, and the outlook for market growth is good. Clearly this dynamic process would initially be much stronger in some sectors than in others.

This effect of increased competition on innovation is given considerable emphasis in the Cecchini Report on the effects of completion of the internal market. The reason for this emphasis is readily grasped once it is recalled that a major motivation for completing the internal market is the failure of Europe's high technology industries to match the performance of the Japanese and the Americans. If increased competition causes more innovation, then it would seem to be exactly what is required to address the key problem of the European economy (Geroski and Jacquemin, 1985). Furthermore, if increased competition stimulates Europe's high technology industries there is likely to be a further possible *indirect effect* of market completion. A revitalisation of Europe's high-tech sectors, and an increase in their rate of technical change and innovation, may ultimately affect other sectors. When high-tech products are capital goods, or intermediate goods for use in other sectors, then sectoral interdependence will cause the effects of changing technology to spread across product markets. In medium or low-tech sectors dramatic changes in products and processes would occur. Of course, independent of market completion in Europe, a tremendous wave of technical change is occurring and this is clearly affecting not only those high-technology sectors which generate innovation and produce high-technology products but also many industries producing traditional products.

An important feature of the likely effects of market completion is the fact that the indirect effects are likely to be more substantial than the direct effects. The relative size of the direct effects and the indirect effects will differ between sectors of the economy. Furthermore, the indirect effects — changes in firm size, technical change and innovation — are likely to interact in complicated ways. In particular, even where the direct effects on a particular industry (cost reduction and/or price reduction) are small (because NTBs are low and the market is already competitive) significant indirect effects are possible, if the competitive environment is changed in such a way as to stimulate strategic

responses by firms. These strategic responses will, of course, differ from industry to industry and will depend on what firms identify as the key determinants of competitive advantage.

3.3 *Firm Size in the Internal Market*

In proposing a framework for analysis of the effects of market completion on the Irish economy we have outlined the two channels of causation — size and competition — as discussed in the “Cecchini Report”. While exploitation of economies of scale and increased competition are not necessarily inconsistent — so long as the market can sustain enough firms — there are, in fact, considerable differences in thinking between those who stress economies of scale and those who emphasise innovation. This is reflected in the “Cecchini Report” — which was assembled from the research of many different economists. In that report there is a clear tension between the view that further concentration of industry is likely (because significant economies of scale remain to be exploited) and the view that small and medium-sized enterprises will benefit most (because they currently suffer most from non-tariff barriers and, most importantly, because they have the characteristics, in particular, the ability to innovate, which are most important for success in a unified internal market).³

The significance of this issue for Ireland arises from the fact that very few large scale activities undertaken by indigenous manufacturing firms have survived Ireland's integration into the European economy. If a significant part of the increased competition created by completion of the market was to take the form of cost reduction based on scale expansion, then the fear naturally arises that Irish firms would find it very difficult to compete. Furthermore, if completion implies increased firm size, then *barriers to entry* of various sorts may *increase* — even though market completion also means increased competition *between these dominant firms* in a given industry (Venables, 1985). If, on the other hand, those who stress innovation are correct, then the increased competition resulting from market completion will be based only to a small extent on exploitation of scale-economies, and will take a number of other forms such as technological activity aimed at product and process development, product differentiation, market segmentation, and redefinition of firms' specialisation (Geroski and Jacquemin, 1985; Ergas, 1984). It might be concluded that in this case the prospects for Irish firms are somewhat better.

3 This tension between different parts of the analysis in the “Cecchini Report” is echoed in a tension between the way the report has been presented. Thus, in launching the report in London, Commissioner Cockfield said “In many areas you will have fewer and larger companies” (*Financial Times*, 10 May 1987). In Dublin, Commissioner Sutherland said that it is wrong to conclude that completion of the internal market will create enormous industrial structures in the centre, and argued that nothing says that a big market implies big firms.

The arguments between these two views turn on a number of theoretical and empirical points concerning the effects of economic integration on competition and barriers to entry, the importance of economies of scale, the effect of technical change on economies of scale, and the role of small firms in the current economic recovery. These issues will be discussed in the forthcoming NESC report on Ireland in the European Community. Consideration of all the arguments leads us to two conclusions concerning the relative importance of the two indirect effects of market completion — scale and innovation. First, any dismissal of firm size and scale economies would be premature (Krugman, 1985). Economies of scale remain relevant and are likely to play a significant part in the competitive response to completion of the internal market.

Second, it may be necessary to re-evaluate the *implications* of this argument about scale versus innovation. Despite the loss of many large indigenous firms, and the absence of such firms now, it may not be the case that if “1992” causes increased competition and innovation, rather than increased scale, the prospects for Irish firms will be better. If there are any significant advantages of scale, then in their attempt to survive small firms are constrained to adopt very particular strategies. For example, small or medium-sized firms can prosper so long as they can acquire some competitive advantage over their bigger rivals. One frequently cited advantage is the ability to respond more rapidly to change. Indeed, the innovativeness of small and medium-sized firms, highlighted by those who stress the second channel of causation, is a perfect example of this. But a strategy of being more innovative than larger competitors is a highly demanding one; it requires considerable management ability, technical skills and probably, technology. Consequently, an internal market with increased competition stimulating innovation by small and medium-sized firms, may be *different* from increased competition based on scale economies, but may be only marginally less difficult for Irish firms.

4. Impact of Completion of the Internal Market on Irish Manufacturing Industry

4.1 General Assessment

In this section the framework for analysis developed above is applied to a number of selected sectors of manufacturing industry. However, it may be useful to begin with a discussion of broad categories of industry. In attempting to identify the effect of completion on specific parts of the Irish economy we are in effect in the same position as a government attempting to inform its industrial policy with an analysis of its country's comparative advantage. Even if we were content to apply the traditional factor proportions theory of trade, or a modified version of it taking account of human capital etc., we are faced with problems identified by Pelkmans: “variants of this theory always explain

comparative advantage at a high level of aggregation; not at the level relevant for deciding industrial production and marketing" (Pelkmans, 1984, p. 273). If the *new* approach to understanding trade, with its emphasis on intra-industry trade, is considered relevant then this problem is even more acute. As Ergas says "it has to be conceded that intra-industry trade is a more complex phenomenon which does not lend itself as readily as the inter-industry trade model to predictions of shifts in competitiveness and comparative advantage" (Ergas, 1984).

Later, some comments on the prospects of a number of manufacturing sectors will be made. At this point we consider broader categories of industry and ask what effect the general increase in competition might have on them. Industries can be classified in many different ways depending on the purpose for which the classification is required (see OECD, 1987; Jacquemin and Buiges, 1988; Emerson *et al.*, 1988). Here we use a classification of industries which emerged during our research for the forthcoming NESC study on Ireland in the EC, and which is similar to that previously used by O'Malley (1987) and Blackwell and O'Malley (1984).

In our analysis of the performance of industry in Ireland since 1965 we identified three groups of industries and sub-sectors:

1. Foreign-owned, grant-aided, export-oriented;
2. Naturally protected: (i) Large scale,
(ii) fragmented;
3. Internationally traded, relatively large scale.

Each of these groups exhibited a very different response to removal of tariff protection. Very briefly, the first group increased both output and employment rapidly during the 1970s and continued output growth in the 1980s. The second group could increase output and maintain, or slightly increase, employment so long as domestic demand was buoyant, but experienced difficulties in the 1980s. The third group consists of those industries which showed almost continuous decline once they were exposed to international competition.

1. *Foreign-owned, grant-aided, export oriented*: The first of the direct effects of market completion — the reduction in costs following removal of NTBs — is likely to be favourable to foreign-owned firms in Ireland. This is because they are not protected, but are hampered by customs barriers, technical standards, and government procurement, and are disadvantaged by the high cost of transport, insurance, and financial services. Therefore, exports from such firms should increase. If the profitability of multinational firms exporting from Ireland increases then, other things being equal, this should increase the attractiveness of Ireland to new foreign direct investors. The only *direct*

measures which may benefit the European competitors of these firms is the development of EC assistance towards R & D. This is likely to aid R & D activities of European firms relative to their US and Japanese competitors located in Ireland (Padoa-Schioppa, 1987).

However, the second of the direct effects — price reduction following increased competition — is likely to be significant for a number of these firms, since several of them are in highly concentrated industries. These *direct* effects of the measures adopted between now and 1992 are likely to be less significant than the *indirect* effects. By the *indirect* effects we mean the restructuring that arises as firms adopt survival strategies; here the effects of completion become linked to the effects of technological change, and the competitors to be considered are not only European firms but American and Asian also. The grant aided, mostly foreign owned, sector in Ireland contains at least two types of firms: those that qualify as *mass-production* or scale-intensive firms and those which are specialised or differentiated (see Jacquemin and Buiges, 1988 and OECD, 1987). The restructuring that occurs in each of these types of industries is likely to be somewhat different.

In *mass-production* or scale-intensive industries (such as office machinery, telecommunications machinery, basic chemicals) it is likely that concentration and co-operation at the EC level will be necessary for competitiveness. It is likely that mergers and take-overs will occur in order to allow the exploitation of economies of scale. Mergers and take-overs between European firms have already occurred. By contrast, to date, co-operation agreements have been mainly with non-EC firms (Jacquemin and Buiges, 1988). It is, of course, very difficult to say how Ireland will be affected. Four categories of firm or project are relevant; existing and potential foreign investors, and EC and non-EC. We would like to be able to put a sign representing increased or decreased investment and employment in each of the boxes below.

	EC	non-EC
Existing		
Potential		

Two broad scenarios can be envisaged. In the optimistic one the Irish plants of EC and non-EC firms would play a significant part in their strategy and, most importantly, Ireland would play a part as a location for non-EC firms in their strategic response to completion of the market and the benefits it brings to their EC rivals. In the pessimistic scenario the restructuring which occurs would involve attempts to exploit agglomeration economies, or other sources of

advantage, such that Irish plants would be discarded, and the strategic response of non-EC firms would involve location of production units linked with their R & D centres. It can be seen that changes in production processes, more than changes in products, are a crucial determinant of which of these scenarios, if any, occurs.

In *specialised or differentiated* product industries the structure is different and the strategic responses are likely to be also. These industries contain large firms, and small firms occupying niches. The emerging industries such as micro-processors, lasers, and medical and surgical equipment fall into this category. Technical change is an important determinant of competitiveness. Firms will mostly continue to occupy niches as the internal market is completed, but the available niches will become bigger. It is hard to see that current producers in Ireland in this category are protected by non-tariff barriers, but some of their competitors in Europe probably are. Consequently, these competitors will experience increased competition. But their *response* to this may include a more aggressive attack on other firms' existing market share. Against this, the response may be further product differentiation. Although scale economies in *production* are less important in these industries, *other* economies of scale and scope can be significant and, if so, they will be brought into play in strategic manoeuvring. Overall, the restructuring of these industries in response to market completion would seem to pose less of a threat; but technology, in its various forms, seems crucial to survival.

2. *Naturally protected (i) large scale*: The source of natural protection differs in each of the industries included in this category: food, drink and tobacco, paper and printing, wood and furniture, and non-metallic minerals. Consequently, the direct impact of the measures to be adopted will differ. Also the *degree* of purely *natural* protection differs and, more importantly, is almost certainly changing. For example, in the food industry access to material inputs as a source of competitive advantage would seem to be declining in significance, and application of scientific advances to products and processes increasing as a source of advantage. Presumably, similar changes are occurring in the other industries.

We may analyse such industries using the framework outline above. What will be the direct effects of market completion? The first direct effect will be a reduction in costs arising from reductions in transport costs, access to cheaper inputs, removal of customs barriers, a more competitive insurance industry, etc. Producers in Ireland and in other countries should also experience a reduction in costs — with costs to the Irish producers perhaps falling somewhat more. The second direct effect of market completion is increased competition. By curtailing the market power of dominant Irish producers this will certainly exert downward pressure on the prices they can charge. If equivalent firms in

other countries also currently benefit from a degree of natural protection (as they probably do in industries like food, drink, tobacco, paper, etc.) then they too will experience increased competition. We would expect some mutual interpenetration of markets. Without considering the *indirect* effects of market completion (exploitation of scale economies and innovation) it is impossible to predict which firm would achieve the greater penetration of the other's market.

If exportable products are developed, then further import penetration would not necessarily be a cause for concern; it would simply be a by-product of intra-industry specialisation and trade. However, the development of exportable products, and the retention of the home market in the face of competition, will probably imply different strategies in different industries and, indeed, in different sub-sectors of each industry. For example, in some lines, the achievement of exports may require a degree of product differentiation and, consequently, *branded* products can be exported. In others, the strategic market structure and/or the technology may dictate that such product differentiation would be very difficult (costly) to achieve, and other sources of competitive advantage, like scale economies in processing, must be exploited in capturing exports for non-branded products.

Whatever classification of industries is used *it is vital that those devising a sectoral/firm strategy correctly identify which type of industry they are in*. For example, if one thinks a given firm is in a specialised/differentiated industry, and devises a strategy accordingly, but really the firm is in a mass-production/scale-intensive industry then the strategy will certainly fail. It may be important to reflect on the policy implications of this observation, for example, the role of management/advisory services.

A related point of great significance emerges from a study of attempts by various British and continental firms to penetrate the European market. In some product areas a European market exists, or could exist when non-tariff barriers are removed. But in others the pattern of demand differs significantly between national markets, and even large international firms have burnt their fingers by trying to supply the whole of Europe with a uniform product (London Business School, Centre for Business Strategy, *Newsletter*, 1988). The existence of separate markets, because of cultural differences or different national distribution systems, does not mean that penetration of them is not possible and, indeed, the imperatives which make exporting necessary for survival probably apply just as much in these sectors. It means that slightly different products must be designed and manufactured for each national market. The possibility of doing this is being greatly enhanced by the availability of new technologies, which provide both the informational requirements and the flexible design and manufacturing facility. But, as noted

above, the pursuit of this strategy requires considerable management ability, technical skills and, possibly, significant financial resources.

2. *Naturally protected (ii) fragmented*: One of the main trends in indigenous manufacturing since accession has been the increasing size of these sectors (metal articles, mechanical engineering, carpentry workshops) as a proportion of total manufacturing employment. At the same time other fragmented industries, such as soft drinks, were altered in the process of accession and have become much more concentrated. This serves to show that these industries are not immutably fragmented.

In general, it is thought that non-tariff barriers are not very significant in these industries. However, it must be the case that there are products which are at the margin of being worthwhile to trade internationally. A reduction in customs and transport costs will tip the balance and may cause import competition. A more significant threat (and opportunity) arises from changes in process and product technology and consumer tastes. For example, many DIY products probably replace the work of firms in fragmented industries. The difference is that the new products are highly tradable. The key feature of fragmented industries is the tailoring of the product to particular local or regional requirements. Where changes in materials or design can *retain this flexibility but centralise production* then all sorts of economies can be exploited. In addition, standardisation of consumer tastes or producers equipment may undermine the competitive advantage of small local firms in these industries. It would seem that, by and large, the innovations required in this area do not require large R & D outlays but depend more on imaginative use of new materials developed elsewhere. It would seem also that firms identifying opportunities in these areas are unlikely to be exporting initially and, consequently, exports as a criterion for assistance from state agencies would be inappropriate.

A major determinant of employment and output in fragmented industries is the *level of domestic demand*. In the long run these industries would gain significantly from the implementation of the EC's co-operative growth strategy for more employment which will permit a faster rate of growth of domestic demand.

3. *Internationally branded, relatively large-scale*: The industries which have been in long-run decline, such as clothing, footwear, textiles, transport equipment, indigenous electrical engineering and chemicals, and some parts of food are characterised mainly by having had little protection once tariff barriers were removed. It follows, of course, that they are in no way protected by the non-tariff barriers which are to be removed by 1992. Some of their competitors in many EC states do receive protection from these NTBs — particularly state aids to industry and voluntary export restraints. To that extent the Irish

industries will receive some boost from completion of the market.

It is of interest that in presenting an illustration of gains from market completion the "Cecchini Report" cites these as industries in which the ultimate fall in production costs would be relatively small, but the proportion of this fall which is a *direct* effect of removal of NTBs would be large — reflecting the fact that not many economies of scale remain unexploited and price competition is already fierce.

But the significant developments in these industries would seem to lie elsewhere. The output of the Danish textile, clothing, and footwear industries, and of British clothing, have *increased* in the 1980s. These industries are the heart of the intra-industry trade argument. Their initial survival in each of the EC-six, and their ultimate survival in EC at all, is the biggest single argument against the traditional factor proportions theory of trade. This survival, where it has happened, would seem to be based on European firms, and states, *transforming these industries from being labour-intensive*. The competitive advantage of these industries would seem now to depend on various combinations of product differentiation (design and quality), production technology, and information and marketing systems.

This group of industries is one where it is important to note that the population of firms in Ireland now is very different from the population that existed when tariff barriers were reduced after 1965. It could be said of that earlier population that, because they had grown up under tariff protection and served a small market, they were, in all probability, less efficient and less cost effective *in an absolute sense* than their potential competitors in other countries. It does not seem possible to say the same thing now. To this extent we would not expect the next round of integration to have the same effects as the first round did.

At the same time, while a large proportion of the output of these industries is exported, output continues its long-run downward path. This contrasts with similar industries in some other member states. This would suggest that the Irish firms, or at least a significant proportion of them, do lag behind in those activities which are the key to real competitive strength. If this is so then, at best, they will be confined to the least dynamic and profitable segments and, at worst, new competitive threats await them.

4.2 *Metals and Engineering*

Metals and engineering employed around 60,000 people in 1987 and this constitutes almost 30 per cent of total employment in manufacturing. However, the sector includes very diverse kinds of activities which are liable to be affected in very different ways by completion of the internal market. Table 1 shows employment in each of the subsectors and gives an indication of the extent to which employment is in foreign owned firms.

Table 1: *Employment in Metals and Engineering*

	<i>Total Employment 1987</i>	<i>Foreign as per cent of total</i>
NACE 22 Metals	1,600	68
NACE 31 Metal Articles	11,600	0
NACE 32 Mechanical Engineering	7,700	52
NACE 33 Office and Data Processing Machinery	6,700	90
NACE 34 Electrical Equipment	18,200	74
NACE 35 Motor Vehicles including Parts	2,700	58
NACE 36 Manufacture of Other Means of Transport	4,100	—
NACE 37 Instrument Engineering	6,900	94
NACE 22 31-37 Metals and Engineering	59,500	61

Source: E. O'Malley, 1987. *The Irish Engineering Industry: Strategic Analysis and Policy Recommendations*, Dublin: ESRI, General Research Series, Paper No. 134.

(i) Electronics: Consider first the electronics subsector of metals and engineering. This consists of office and data processing machinery (NACE 33) and parts of electrical equipment (NACE 34). Electronics has experienced rapid growth of output and productivity with slow growth of employment in the 1980s. It has been shown that an important feature influencing the behaviour of foreign firms is the life cycle of their products. It is relevant therefore to note that most of the firms in electronics in Ireland came here during the 'seventies and that they came relatively early in the life cycle of their product. Other relevant features of these firms are that they are largely non-European (most from US) and tend to be small by the standards of multinational corporations.

The grant aided foreign owned sector in Ireland contains at least two types of firms: those that qualify as mass-production or scale-intensive firms and those that are specialised or differentiated. In mass production or scale-intensive industries the direct effects of market completion would seem likely to be the following. The firms in Ireland are protected by few NTBs (apart from the incentives provided by Irish state agencies) whereas their competitors in the rest of Europe would receive considerable protection — particularly through preferential government procurement. While all firms should experience an initial reduction in costs, because of the removal of various NTBs, those which are currently protected by other NTBs will also experience pressure to reduce *price*. Indeed, the second direct effect of market completion identified in our framework for analysis — increased competition

— is likely to be experienced quite widely. This is because much of the electronics industry, for example, office machinery and data processing equipment, is fairly concentrated, allowing firms high price-cost margins (*The Economics of 1992*, Emerson, *et al.*, 1988).

However, electronics is one sector where these direct effects on costs and price-cost margins are likely to be small relative to the indirect effects. These indirect effects consist of exploitation of economies of scale and increased innovation. In outlining the possible effects of market completion we noted that four categories of firm or project are relevant: existing and potential foreign investors, and EC and non-EC firms.

Existing projects: Most of the existing electronics manufacturers of Ireland are non-European firms. Assessment of the impact of market completion therefore boils down to an assessment of the prospects of these firms. Electronics is one sector where it is especially true that the impact of technical change is likely to be more significant than the impact of market completion *per se*. The electronics sector is likely to continue to experience rapid growth of demand. A number of likely trends in the sector have been identified and their implications for producers located in Ireland need to be evaluated. First, the pattern of demand is likely to shift with increased use of information technology in manufacturing and retailing, whereas to date much of the demand was from the financial services sector. Second, a number of technical trends in the industry are expected, or certainly hoped, to improve the prospects of European firms relative to the industry leaders from the US and Japan.⁴ Third, the existence of economies of scale at the level of the product are expected to lead to considerable organisational change as firms form mergers, co-operative agreements, or pursue take-overs, in order to spread the costs of development and gain access to new markets.

Two considerations are relevant to the existing electronics industry in Ireland. First, what will happen to the market share of the producers located in Ireland? Second, how will the reorganisation of the industry into larger units affect the industry in Ireland? There are forces working in both directions. The major positive force is the opening of government procurement. Public procurement represents up to 60 per cent of information technology purchases in the EC. Opening of public procurement should both increase the market share of firms located in Ireland and decrease the disadvantages of being located in Ireland. On the other hand, if measures taken to improve the competitive position of European firms actually succeed then producers in Ireland, being mostly non-European, must experience more competition.

⁴ These technical trends are the following: (1) continued downsizing will threaten producers of mini-computers and mainframes; (2) the emergence of standard operating systems will allow an escape from IBM proprietary systems; (3) increased emphasis on software; (4) the emergence of "open" systems which allow communication between systems produced by different manufacturers.

Some parts of the electronics industry are in specialised or differentiated environments. These environments contain both large firms and small firms occupying niches. The emerging industries such as microprocessors, lasers, and data processing software fall into this category. Technical development is an important determinant of competitiveness. It is expected that on completion of the market, firms will continue to occupy niches but the available niches will become bigger. Some currently differentiated product industries are likely to eventually become mass-production industries while others will remain highly specialised.

For example, opinions differ on whether the software industry is destined to evolve like other industries — a few volume suppliers and many niche companies. Some consider that it cannot remain a “cottage industry”, and once suitable distribution systems develop, volume suppliers will inevitably emerge. Others consider that the industry is unavoidably specialised and therefore will remain highly fragmented. Since Ireland has a number of indigenous firms in the software sector the strategic choices concerning product range and geographical area to be served will be significant.

New foreign direct investments: A number of forces will determine the future flow of foreign investment in electronics in Ireland; the completion of the internal market is but one of these. First, there are strong autonomous trends in the pattern of foreign direct investment on a world scale. After several decades of sustained growth, US manufacturing investment in Europe peaked in 1980. Japanese foreign direct investment has increased in recent years but has been concentrated in the US. There are global macroeconomic reasons why this pattern cannot continue, and many expect Japanese investment in Europe to increase. Indeed, there is some evidence that both Japanese and US foreign investment in Europe has increased in recent years (Duffy, 1988). Technical change is influencing the attractiveness of foreign investment in manufacturing in complicated and, as yet, unknown ways. The enormous growth of inter-firm collaboration in high technology sectors, and its active encouragement by the Community, must influence the attractiveness of foreign direct investment. To date much of the collaboration between European firms has been in research. Eventually decisions about the location of facilities for production of new products will be made by the emerging European firms. Shortening product cycles and other developments are changing the criteria upon which location decisions are being made.

It is in the context of these trends that the effect of market completion on the flow of foreign direct investment into Ireland must be considered. There is reason to believe that completion of the market will increase non-European foreign direct investment in Europe since fragmentation of the European market seems to have limited such investment. Japanese and other firms note

that to date European governments have been able to apply pressure to have plants located nationally, thus greatly limiting the exploitation of scale economies. While this increase in investment in Europe is likely to increase investment in Ireland two other factors should be noted. First, the Community is strengthening its anti-dumping measures by imposing mandatory local content rules in order to crackdown on far-eastern "screwdriver" plants which merely assemble imported components. This measure may increase rather than decrease investment in Europe, but it is difficult to say what share of this might come to Ireland. The ability to provide local sub-supply of parts to a high standard of design and quality is likely to be an important factor in influencing the location of these investments. Secondly, competition between EC countries for foreign investment has become intense. Even if state aids by richer member states were curtailed, Ireland will experience increased competition with Greece, Spain, Portugal and the UK. The recent flow of foreign investment into Spain is evidence of this.

(ii) Electrical Engineering: In industries such as domestic electrical appliances there is evidence that European plants are below minimum efficient scale, due to fragmentation of the market. This applies both to European firms and non-European producers and arises largely from the power of states to influence the location of plants and a host of non-tariff barriers. As a result large companies like Philips have far more plants in Europe than would be efficient (De Jonquieres, 1988). As in the industries considered earlier, most existing plants in Ireland are already oriented to the export market, and it is their competitors who should experience the price-cost squeeze when NTBs are removed. However, this is also an industry in which these direct effects on costs and prices are likely to be small relative to the indirect effects of scale economies and increased innovation. The impact of these indirect effects on firms in any individual country is difficult to predict as it depends on the strategic restructuring undertaken by firms.

The indigenous segment of electrical engineering consists of a small number of relatively large firms and a fringe of smaller firms serving local markets. Several of the larger firms rely on public sector purchasing of telecommunications equipment. It is not clear what the future growth demand will be.

(iii) Manufacture of Metal Article and Mechanical Engineering (NACE 31 and 32): In Ireland these sub-sectors consist of a large number of very small firms serving local markets with products differentiated to the customer's requirements. Such a structural environment is best described as fragmented. The features of this environment are very low exit and entry costs and few economies of scale, so that many small firms exist with varying and unstable margins, which often depend on the quality of their management. When we

apply our analytical framework we see that there are likely to be few effects from completion of the internal market. The fortune of these sectors depends on the growth of domestic demand, as is apparent from the slow growth of output and substantial decline in employment since 1980.

However, the emerging pattern of technical change may have some implications for the manufacture of metal articles and of mechanical machinery. A notable feature of the flexible manufacturing made possible by the use of computers in design and manufacturing is the emergence of two opposite trends. There is evidence that the current wave of technical change is undermining scale economies in mass-production, but injecting scale economies at the batch production and of the size spectrum (Perez, 1983). As a result it may be possible for large producers to achieve the extreme product differentiation previously available only to the fragmented producers in metals. This combination of product differentiation and economies of scale may make it difficult for small-scale machinery suppliers, using conventional technology, to compete with machinery produced with automated flexible manufacturing systems (Kaplinsky, 1984).

(iv) Production and Preliminary Processing of Metals (NACE 22): This sector is dominated by Irish Steel Ltd., a state owned company. Its production of steel benefits from aid provided by the EC to the industry in the Community. Consequently, its future depends on what Community regime emerges for the steel industry rather than on the completion of the internal market *per se*.

(v) Manufacture of Motor Vehicle parts (NACE 35): This sector comprises 115 companies employing about 2,700 people. Developments in the motor industry internationally mean that components' suppliers will be more than ever under the control of their customers — the motor manufacturers. In addition to closer collaboration between car manufacturers and components manufacturers there is evidence of a process of concentration in the sub-supply sector. Ford has announced plans to encourage the establishment of components plants next to its major European assembly plants, while General Motors' strategy for the 1980s is to have all component suppliers within 100 miles radius of its final assembly plant (Griffiths, 1988). On the evidence of the past this increased scale will tend to put pressure on producers in Ireland.

As in several other industries the completion of the internal market is likely to speed up developments which are occurring in any case. One of these is the introduction of new organisational procedures such as "just in time" production. This is designed to minimise the amount of capital tied up in car manufacturer's inventories and, other things being equal, will tend to induce producers to buy components from firms located near their final assembly plants. At the same time, in certain sectors, information technology is being used to greatly increase the efficiency of decentralised networks of manufacture,

supply and distribution (Parkes, 1988; Lorenz, 1987). The overall spatial effects of these new technologies is a highly complex phenomenon which is only beginning to be understood.

4.3 *Clothing (NACE 453-456)*

The clothing industry in Ireland consists of about 350 companies of which over 80 per cent are in the small industry category — i.e., employing less than 50 people. Over half of the companies employ fewer than 15 people. There are only about 12 clothing companies employing more than 200 persons on one site. Of these, 10 are foreign owned. Employment in the industry has fallen by almost 20 per cent since 1980 but output in 1987 was slightly lower than in 1980. This implies an increase in productivity of only 20 per cent over the seven year period. About 60 per cent of the industry's output is exported, with sales to the UK accounting for over half of this amount. Nevertheless, nearly half of Irish clothing companies rely exclusively on the domestic market.

The long-term development of the clothing industry in all EC countries is conditioned by one fact. The industry has remained labour intensive because of the difficulty of automating the key stage of production — the sewing of cloth. The effect of this is that labour costs have remained an important influence on competitiveness, and, in particular, that all EC countries have been threatened by producers in low-wage economies (OECD, 1988). One of the implications of this has been the adoption by the Community of quotas on the importation of clothing from certain low cost sources under the Multifibre Agreement (MFA). Indeed, it is a feature of both the clothing and textile industries that government measures to support the industry typically take the form of trade measures. Otherwise the industry is highly competitive internationally. The only NTBs inhibiting trade within the Community are those which apply to all products, such as the costs of border checks or the indirect effects of NTBs in other sectors, such as insurance and transport. Completion of the internal market should even out these costs. Clothing is one industry in which the direct effect of market completion may worsen the position of Irish producers relative to their EC competitors. Unlike many other industries, producers in other member countries are not protected by NTBs such as technical standards and regulations or government procurement practices. In addition, completion of the internal market will sharpen the competition from non-EC low-cost countries. This will occur because abolition of border controls will end quota restrictions on movement within the EC of clothing imported from non-EC producers.

The inability to mechanise the chief assembly function — sewing — does not imply that there are no technological opportunities in the industry, nor that scale is of no competitive advantage. The paradox of technical change in the

clothing industry is that it is in the high skill operations such as design, engineering and cutting that technological developments have so far taken place, while the low-skill functions have resisted automation. The introduction of computer aided design (CAD) has transformed the design, grading and cutting stages. It is significant that use of these technologies allows only small savings in labour cost but considerable savings in materials and increased flexibility. In addition, such systems are highly expensive and require considerable reorganisation, which makes high demands on managerial skills. For all these reasons these new technologies are much more easily adopted by large firms than by small. This is an example of how new technology can make scale and flexibility, traditionally conflicting with one another, into complementary advantages within a firm.

Faced with the limited potential for automation, clothing producers in many countries have developed other strategies to secure or retain competitive advantages. The first and perhaps the most important of these is product innovation. This term covers a wide array of actions all of which are intended to escape the area of fierce price competition. This may involve the constant development of new varieties of clothing items, or upgrading marketing strategies by *creating* labels, or working for those who already hold such labels. Another way of differentiating the product is to increase the quality of service rendered to the ultimate consumer. This requires close co-operation with the wholesaler and retailer, and may require close ties with textile manufacturers. Note that most variants of this strategy of product innovation imply the need to use the new technology *and* to reorganise, because otherwise the shorter production runs involved will increase costs. Consequently, investment in new technology and product innovation cannot be seen as *substitute* strategies.

A second strategy is designed to circumvent the implications of the high labour intensity of the sewing operation and consists of "outward processing". This involves the export of the cut clothing parts, for assembly by a sub-contractor in a country with low wage rates, and reimport of the assembled garment, paying import duty only on the value added to the cut pieces. The clothing industries in the US, Germany, the Netherlands and France are reported to make heavy use of this strategy. This procedure is concentrated on low and middle-priced items which are not subject to fast change in market demand and can, therefore, be produced in long production runs.

Thirdly, a number of organisational changes are occurring in the clothing trade which are of major significance to clothing manufacturers. The first of these is one that can be seen in retailing generally; it consists of the growth of multiple outlets at the expense of small retail shops. This suggests that there are some economies of scale at the distribution and marketing stage of this industry. As a result access to the multiplies can be crucial to survival even in the home

market. But if access is achieved this will provide the manufacturer with continuous contact with the consumer. In addition, in some cases clothing firms themselves are undertaking organisational changes which give them access to the consumer and a highly flexible production facility. This may consist of establishment of retail outlets, as in the case of the Italian company Benetton, or formation of trading houses, which constitute combinations of competitors. These organisational changes also seem to involve the extensive use of information technology.

These technical developments and strategies illustrate some of the threats and opportunities which will face clothing manufacturers in Ireland. We may start by noting that some of the larger Irish producers are already taking advantage of opportunities to introduce information technology into the design and pattern making procedures, and intend to automate the cutting stage. The case of Magee's of Donegal also illustrates the advantages which stem from joint textile and clothing manufacture. But this response of a relatively large scale producer highlights the difficulties faced by much smaller firms. Almost all aspects of the strategies outlined above will be significantly more difficult for the small and very small firms to adopt, and will tend to favour the large over the small. Where expensive new investment or product innovation are not possible, cost will continue to be a key determinant of competitive advantage. In these areas, low cost competition will continue to be experienced not only from non-EC producers but also from some UK firms where very low wages are paid.

One segment of the clothing industry which has the potential to escape extreme price competition through product innovation is the fashion or designer end of the market. Yet a number of high profile designers in both Ireland and the UK have experienced difficulty in recent years. In the UK this has been attributed to a lack of venture capital and to problems in finding suitable sources of *production* — the large manufacturers cannot or will not provide the small quantities that the designers need, while the "sweatshops" cannot deliver the right quality. As a result, UK designers have turned to Italian producers who have close liaison with designers and are capable of dealing with small quantities. Given that designers are potentially capable of providing one of the most valuable competitive advantages to the clothing industry — market related design and product differentiation — the source of business failure among this group, and of the remarkable success of the French and Italian industries, could repay investigation.

4.4 *Textiles (NACE 43)*

The Irish textile industry consists of about 200 firms, the majority of which are indigenous. However, many of the larger firms are foreign owned and these

account for around 60 per cent of employment. The industry has seen a long-run decline of both employment and output — with a particularly sharp contraction in employment since 1980.

In assessing the threats and opportunities it is important to note some features of the industry internationally. This is an industry in which there has been fierce international competition for many years. The traditional methods of production were readily adopted in many less developed and newly industrialising countries and, given their low wage costs, they became highly competitive in this labour-intensive industry. Initially the response in more developed countries was concentration, in order to create firms sufficiently large to undertake big investments in labour-saving technology. However, one of the characteristics of textile technology is that there are few obstacles to its diffusion to developing countries. The adoption of mechanised spinning, and especially weaving, in less developed countries led to a reorientation of the industry in developed countries towards higher value-added goods, and this revealed the advantages which small and medium-sized firms possess. At the same time the use of modern textile technology in developing countries has tended to narrow or even wipe out the competitive edge which these countries traditionally derived from their low wage costs. Consequently, in the modern textile industry worldwide, both capital and energy costs are major factors.

This thumbnail sketch indicates that the experience of the industry in Ireland is in fact similar to that of textile producers in many developed economies. Indeed, the modernisation of the Irish industry seems to be more advanced than in several other OECD countries. Thus while the absolute contraction of the industry will be very difficult to reverse we would look for increased productivity as evidence that investment in new technology has stabilised the industry. This will be necessary to maintain a share of even the Irish and British market against the highly productive West Germans and Italians who now dominate the European industry.

Given the existence of fierce international competition in textiles it is unlikely that completion of the internal market will greatly alter the competitive climate in the industry. The removal of NTBs, such as customs delays, will probably just magnify prevailing sources of competitive advantage and disadvantage. High capital costs seem to be a feature of the industry in general and the scope for further technical change and automation implies that capital requirements will continue to grow. This could tend to give large and well capitalised companies an advantage over others. The production of synthetic fibres is a large scale and highly energy-intensive process and relative energy costs are an important determinant of competitiveness.

However, in other parts of the industry the high productivity achieved by automation and large scale production tends to reduce product flexibility.

Smaller firms can gain the competitive advantage of flexibility and product innovation in high-value product niches. These are also the high growth markets in an industry which has in general experienced slow growth of demand for many years. However, if pursuit of a niche strategy does not demand scale it does make demands on management and other skilled labour inputs. Furthermore, the product differentiation which is the essence of the niche strategy will itself be challenged. While pursuit of a niche strategy will allow some escape from price competition, and the attendant need for large scale capital outlay, it will not permanently remove cost as a competitive advantage or disadvantage. Future technical change in the textile industry is likely to focus on reconciling cost reductions with small volume output.

Finally, a more liberal trading regime may follow the expiry of the Multifibre Agreement in 1991. However, it is not possible to forecast what arrangements will apply. Even if the new regime exposed Europe to greater competition from less developed countries it should be noted that, on the evidence of the past, this competition would be very different in the various segments of textiles. Import penetration of OECD markets by less developed countries has been particularly important in the field of woven fabrics, especially cotton, much less in the field of yarns, and almost non-existent in knitted fabrics.

4.5 Printing and Publishing (NACE 473-474)

This sector of manufacturing consists of about 300 establishments, most of them Irish owned, employing around 10,000 people. Employment in the sector has fallen by about 14 per cent since 1980 — which is a smaller fall than was experienced in most other branches of manufacturing. Output has remained constant since 1980, having grown slowly during the 1970s. These developments contrast somewhat with the performance in other OECD countries, where employment fell quite sharply in both the 1970s and 1980s, but output has nevertheless increased rapidly — indicating strong productivity growth.

Printing and publishing is not a highly traded activity. For the most part, the major exporters of printed matter are also the largest importers. Import penetration of the Irish market is relatively high at around 30 per cent and exportation of about 12 per cent of Irish production is also high by international standards. On a world scale, Europe is the historical centre of the world printing and publishing industry and accounts for well over half of world trade. However, language plays a large part in governing the pattern of trade, and trade in English language material is much the most important. Despite these historical patterns two new trends in the industry should be noted: growing imports from non-OECD countries and the internationalisation

of production. The latter trend is continuing unabated with multinational publishing houses engaging in foreign investment, mergers and acquisitions.

A remarkable feature of the print era was the use of one basic technology for over 500 years. However, the past 25 years have been a period of rapid technological change in printing largely due to computerisation. Much of the most far reaching technical change in printing and publishing has been the application of computers and microprocessors to the pre-press or composition stage of production. This, and changes in other parts of the overall process, have lowered costs and greatly reduced barriers to entry. As a result the industry is less concentrated and is comprised of smaller firms than most other OECD manufacturing sectors (OECD, 1988). This is more true in printing than in publishing, where there are economies of scale, and there has been a substantial number of mergers and acquisitions and diversification from book publishing to telecommunications media.

The impact of new facsimile equipment, which allows composition work done at one location to be transmitted electronically to another for printing, is difficult to predict. On the one hand it would seem to contribute to greater concentration of sales in a smaller number of *firms*. But looked at geographically it may facilitate a wider dispersal of actual printing and publishing activity. For example, in Japan facsimile installations are used to transmit newspaper text from central newsrooms to provincial centres. Conversely, this technology will enable Irish firms to tender for foreign pre-printing contracts with the actual printing being done in the relevant markets. The pattern of sales and purchases will depend on technical ability and the relative costs, as determined by economies of scale in print runs and the price of transportation. We stress technical ability along with costs of transportation, etc., because the technical changes of recent years have changed the competitive basis of the industry from wage costs to the rate of technological innovation.

In fact in the major OECD economies the diffusion of electronics technology has been greater in printing and publishing than in any other manufacturing sector. This would not seem to be the case in Ireland where the introduction of new technology has been slow in many segments of printing and publishing. Also, in many countries the introduction of new technology in the ten years since 1985 coincided with increased output growth and faster growth than in manufacturing in general. Both the UK and Ireland seem to be exceptions to this trend and there remains significant overcapacity throughout the traditional sector of Irish printing and publishing.

Further technological change seems likely and may cause job losses in newspaper, magazine and book printing, but not in publishing or in commercial printing. This trend will be reinforced by the formation of larger

book publishing and printing firms through mergers and take-overs.

Given the existence of economies of scale in book publishing and printing, but smaller economies and fewer barriers to entry in commercial printing and publishing, it would seem that the state agencies' efforts should concentrate on those companies with the potential to produce and sell into expanding market niches, such as the highly successful computer manual business.

4.6 Chemicals and Pharmaceuticals

Chemicals and pharmaceuticals is one of the top performing sectors of Irish manufacturing since 1980. It employs around 12,000 people, mostly in foreign owned firms, and has achieved rapid growth of output — predominantly for export. Although some firms are involved in both chemicals and pharmaceuticals, the market situation in the two sectors is so different in the EC that the effects of market completion should be considered separately.

(i) Chemicals: The European chemicals industry is already characterised by heavy cross-border trade. Thus there virtually exists a European-wide market, despite the continuation of certain non-tariff barriers. Indeed, chemicals is one of the few areas of European manufacturing able to compete effectively with the US and Japan. It is an industry in which there are considerable economies of scale — but most of these would seem to have been exploited already. Consequently, the industry is dominated by very large multinational firms.

The NTBs in chemicals arise because of customs delays and costs, and national regulations governing health, safety and product quality. These certainly restrict trade to some extent. They also induce a certain duplication of R & D as firms must develop products which satisfy varying technical requirements in individual EC countries.

Therefore, the main direct effect of completion of the market is likely to be a reduction of costs and an increase in competition. When we consider the indirect effects there seems little basis for significantly increased scale. The impact of the initial price and cost reductions is likely to differ between highly differentiated products and bulk industrial chemicals. Firms producing differentiated products should be able to avoid greatly increased competition. Others may experience competitive pressure on their profit margins. It is possible that this will stimulate innovation as outlined in the second channel of causation in our framework.

The chemical industry in Ireland is dominated by foreign owned firms. In the other sector of manufacturing where foreign firms are important, metals and engineering, we said that there was a possibility that these firms would rationalise their European plants and this could present threats and opportunities for Ireland. Does a similar outcome seem possible in the chemicals sector? In our view a major restructuring is unlikely. To see this it is

worthwhile considering research and production separately.

In the case of *research* activities very few of the foreign companies have located significant R & D in Ireland, tending generally to rely on the parent company for both this and marketing. Indeed, in the chemical industry generally research tends to be much more centralised than production. There is recent evidence of a tendency to decentralise R & D. However, the purpose of this is to ensure that more R & D is done in harmony with the marketing and operations divisions of the company. But since Ireland is not a major market for chemicals it seems unlikely that decentralisation of research would include this country. Indeed, much of this decentralisation of research is to the US and Japan, and reflects the *global* scale of the major European firms.

When we consider the location of *production* capacity it is seen that 1992 is unlikely to induce major relocations. We mean this in two senses. It seems unlikely that firms will wish to centralise or rationalise their European operations into fewer sites, as might occur in electronics or electrical appliances. Consequently, there seems to be little threat to the industry in Ireland. But it seems equally unlikely that firms would re-locate their final or other stages of production alongside their plants producing intermediary products in Ireland. The reason for this is that in the chemicals industry there are a number of motivations, quite apart from non-tariff barriers to trade, to establishing and maintaining local manufacture in many countries — and particularly in major markets.

As far as the indigenous firms are concerned it should be noted that, despite the dominant role of giant corporations, there are niche markets which could be served. However, there are high entry costs and small firms can experience both production and marketing difficulties. These difficulties of small scale are barriers to entry which exist already rather than effects of economies of scale which will be exploited by larger producers after 1992.

(ii) *Pharmaceuticals*: The pharmaceuticals sector presents a remarkable picture. In one respect it is a highly international sector dominated by a relatively small group of large multinational companies. At the same time it is the sector in which the national markets are, perhaps, most controlled by national authorities. This national regulation arises from the fact that the major purchaser tends to be the national health care authority and the usual public procurement practices apply. In addition, there are very different and costly national product registration and approval procedures and there is a complicated set of national price control systems. The manufacture of active ingredients is confined to a limited number of sites, including Ireland, but their conversion into dosage forms is highly decentralised.

A vigorous implementation of the internal market programme could have an enormous impact on the European pharmaceuticals industry. Most aspects of

these changes would tend to be favourable to pharmaceuticals sectors in Ireland.

A more harmonised acceptance of standard specifications and registration procedures could alter the location of "finishing plants". Foreign firms may reap considerable economies of scale by reducing the number of finishing plants and locating these at a limited number of sites. Ireland should be a strong candidate for the location of these plants. However, opinions differ on the likelihood of multinationals actually closing down a number of plants, as this may be both politically difficult and commercially damaging. To say that it could be politically difficult is to implicitly admit that discriminatory government procurement of drugs will continue after 1992. Firms may not close finishing plants for commercial reasons because the nature of the pharmaceuticals market is such that firms must maintain a presence, at least in the form of a distribution system, in many countries.

The harmonisation of product approval would help Irish indigenous producers of generic drugs to achieve access to various European market.

The existing complicated set of national price control systems tends to favour locally based suppliers. For example, Britain has used its freedom over price setting to establish a price-control scheme that lets UK-based companies charge relatively high sums for their products in their home market. This has given the UK industry a high degree of stability and a base from which to attack overseas markets. While Ireland is a high price country the small size of the Irish market means that this high price can do little to support or attract pharmaceutical producers. Consequently, movement towards a more harmonised approach to price setting would benefit the industry in Ireland by putting pressure on producers in other countries.

However, it is possible that harmonisation of prices would involve a reduction of the average price received by the industry in Europe generally. If this were combined with greatly increased access to markets, resulting from common approval guidelines, then it would have a very substantial impact on the industry in Europe generally. This could induce substantial restructuring, including the possibility of greater concentration of the industry. The impact of such a substantial restructuring on the Irish pharmaceuticals industry is difficult to predict.

Finally, all of the above was a consideration of a vigorous implementation of internal market measures. In general, we have analysed the likely effects on the assumption that the market completion programme will be implemented. However, in the case of the pharmaceuticals industry there seems to be more than average doubt about two key harmonising measures. First, agreement on common approval guidelines by the health authorities of the member states would be a considerable diplomatic and administrative achievement.

Secondly, the "Cecchini Report" points out that no harmonisation of prices is expected in the Community in the immediate future. These reservations serve to qualify the expectations outlined above.

5. Conclusions

5.1 "1992" and The Changing Economic Environment

One of the most important general points to emerge from this analysis is that "1992" must be seen in the context of other changes in the general economic environment affecting businesses. This is true for all countries but especially so for Ireland. The reason for this is that large parts of the Irish economy are already highly oriented to the international economy and are protected by few non-tariff barriers. The important aspects of the general economic environment are technical change, organisational change, macroeconomic conditions (including the level of demand, exchange rate movements, the prices of credit and raw materials) and the emergence of important new producers, in particular from Japan and the newly industrialised countries. Much the most important of these would seem to be the phenomenal wave of technical change which is sweeping the world economy. Indeed, it might be seen as largely the cause of the rapid change in the ownership and organisation of companies. The importance of technical and organisational change was confirmed in the application of our analytical framework to Irish manufacturing industry. In several sectors the dominant threats and opportunities seemed to be those created by technical and organisational change rather than the removal of non-tariff barriers.

The current wave of technical change can be seen as an autonomous event — independent of the completion of the European market. Yet the two events are not fully independent. This is because one of the most significant features of the current wave of technological change, and associated organisational restructuring, is that it seems to be *inherently* international or, perhaps more accurately, supranational (Perez, 1983). This international dimension probably arises in part from the provision of unprecedented data-management capabilities and telecommunications infrastructure which allows the efficient management of transnational firms. In addition the radical productivity increases made possible by computer-aided design and manufacturing mean that for businesses to reach viable size the volume of output and the range of products of a given plant must serve an international market. The same applies in the production of services such as information and telecommunications. In short, national markets, particularly small national markets, would be a hindrance to the full deployment of the new technologies.

Recognition of these facts allow us to see "1992" in a new light. The move to complete the internal market can be seen as partly a response to a set of changes which are occurring in any event and which will inevitably increase the international aspect of economic life. In this context the decision to complete the internal market would seem to do two things. It helps to ensure that these new developments in business occur fully in Europe, rather than influencing Europe but partly passing it by. Secondly, it allows the Community to influence the process of economic and social change; some features of the technology and new organisational patterns are indeed inherent and therefore inevitable — an example would be its internationalism — but many other are not. For example, while the new trends in technology and business undoubtedly demand *changes* in social relationships within the firm, and between groups and individuals in society, the exact new pattern of social and distributional arrangements is not determined rigidly by the new economic environment. While no single national government in Europe can greatly influence the economic environment, or fashion the social developments which a rapidly changing economy produces, there seems little doubt that the European Community can.

5.2 Threats and Opportunities facing Irish Manufacturing Industries

Given the connection between "1992" and the autonomous changes in the world economy, we have adopted a fairly broad view when assessing the threats and opportunities facing Irish firms. Thus it was considered appropriate to mention threats and opportunities which arise from technical or other business developments. However, as far as possible we mention whether a particular threat or opportunity is a direct result of market completion or not.

One general observation can be made about the threats and opportunities facing manufacturing industry in Ireland. Most manufacturing sectors in Ireland are hindered rather than helped by the sort of non-tariff barriers which fragment the European market. The clearest examples of this are the extra costs imposed by customs checks and the imposition of national technical standards. The first falls heavily on Irish manufacturers because a high proportion of their output is exported, and access to European markets can involve crossing several borders. Indeed, some commentators on "1992" have generalised this and concluded that small countries will gain most from completion of the market because a higher proportion of their production and expenditure is traded goods.

However, given this general observation, that there are few non-tariff barriers protecting Irish manufacturing industry, it is important to think clearly about how this will translate into threats and opportunities after 1992. The completion of the internal market can benefit a firm only by lowering costs

and giving it access to markets from which it was previously excluded.

In order to assess the extent of this beneficial effect it is necessary to assess the nature and extent of the non-tariff barriers which inhibit Irish industry. Manufacturing firms in Ireland are constrained by NTBs, in the form of high costs, not only because of the frontier delays, foreign technical standards, and foreign government procurement, but also because of the fragmentation of the European insurance industry, banking industry, transport industry, and relatively high indirect taxes on motor vehicles and fuel.

Application of the analytical framework developed in Section 3 to selected industries revealed that the *direct* effects of market completion are likely to be positive for most sectors of Irish manufacturing. Possible threats came to light when the *indirect* effects were considered and when other factors like technical change were taken into account. Although I have not discussed all sectors of manufacturing in this paper, the analytical framework developed here can be applied to the remaining sectors by those who have detailed knowledge of them. This approach is further elaborated and applied in the forthcoming NESC report on Ireland in the European Community. The following is a summary of some of the threats which emerged from the analysis outlined above:

- In electronics existing plants and the future flow of foreign direct investment were considered separately. Existing producers should find the *direct* effects beneficial, but these are likely to be small relative to the indirect effects. In this industry the *indirect* effects are very difficult to predict since they depend on firm's *strategies*, as much as on objective economic conditions. The flow of new foreign investment to Ireland is likewise hard to predict. While foreign direct investment in Europe certainly seems to be reviving, Ireland will experience increasing competition from new member states Greece, Spain and Portugal.
- In electrical engineering a threat exists because large firms, both European and non-European, seem likely to reduce the number of plants they operate in Europe and this process contains potential dangers.
- In metal articles and mechanical engineering a possible threat to Irish producers is presented by technical change; current trends in technology will allow large producers to meet highly specialised needs with differentiated products.
- The processing of metals may be threatened by changes in the Community steel regime.
- In the automotive components sector, possible threats arise from the impact of technical and organisational change on the location of plants supplying the major motor manufacturers.

- Clothing is one sector where the *direct* effects of market completion may be negative because, unlike most other industries, producers in other member states receive little extra protection from non-tariff barriers. In addition, the indirect effects of market completion may contain threats since the technical and organisational requirements for competitive success seem to be more easily acquired by larger firms.
- In textiles what threats exist seem to arise from the high and rising capital costs which are created by technical change. This tends to give large and well-capitalised companies an advantage over others.
- Printing and publishing is a sector in which threats arise for different parts of the industry from technical change and from economies of scale.
- In this paper I have not undertaken a detailed examination of the food industry. Nevertheless, it can be said that application of the analytical framework developed here shows that in the food processing sector the small scale of the Irish businesses relative to their European and especially US competitors was identified as a possible cause for concern.

However, these threats do not define the inevitable outcome of completion of the internal market. There are two reasons for saying this. First, as well as threats there are considerable opportunities — as indicated by the generally beneficial *direct* effects of market completion which were identified in the analysis. Second, many of the threats outlined above can be overcome if the correct corporate and public policy response can be devised. But a prerequisite for formulation of these responses is realistic analysis of the process of economic integration. This paper has suggested how such analysis might proceed.

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1992: THE DISTRIBUTION SECTOR

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1 Introduction

Much of the early discussion of the effects of 1992 focused on the industrial sector. This was understandable as that sector plays a vital role in the development of the Irish economy, as in the economies of the other members of the EC. However, the numbers employed in the Market Services sector of the economy are substantially greater than in the industrial sector. As the proposals of the European Commission in their White Paper *Completing the Internal Market*, 1985, also have major implications for the services sector in Ireland and elsewhere in the EC, it is important that the proposals should be considered in a wider context. In this paper we examine the implications for the distribution sector in Ireland; in particular the effects on the pricing and sale of goods by manufacturers, importers, wholesalers and retailers. While these changes also have major implications for the transport industry, they are not considered in this paper.

Section 2 examines the structure of the distribution sector and its significance in the Irish economy. Some comparisons are made with the situation in other member states of the EC. The detailed proposals of the European Commission which directly affect the distribution sector are discussed in Section 3. Section 4 considers the reasons why prices in Ireland differ from prices elsewhere in the EC.

Clearly if prices differed due to the insulation of the Irish distribution sector from markets in other EC members, 1992 would represent a major change in the environment. In the light of this analysis the likely effects of 1992 on the distribution sector are discussed in Section 5 and conclusions are presented in Section 6.

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2 The Structure of the Distribution Sector

The distribution sector can be defined in a number of different ways. In this paper we are concerned chiefly with the retail and wholesale sectors and, to a more limited extent, with the relations between these sectors and manufacturing industries in Ireland and elsewhere. We include the operations of importers with those of the wholesalers as, in many cases, the two functions are performed by the same company. While it is of great relevance, we do not consider how goods are physically transported from one firm to another firm. While this is obviously of great importance to the way the distribution sector operates, it involves a wider range of issues concerning the regulation of transport, at both a national and an international level.

Organisation

Traditionally the distribution sector is considered under two headings: retailing and wholesaling. Retailers sell directly to the public whereas wholesalers sell to the "trade". Even 20 years ago this distinction was by no means clearcut and changing economic circumstances have led to considerable integration of the two functions. In the case of Ireland, there is the added complication that many of the goods sold in our shops, or used as inputs in the industry and services sectors, are imported. The organisation of the import trade, while very similar in character to the wholesale sector, in certain cases represents an additional link in the distribution chain. In other cases the importers' functions have been merged with those of the wholesaler and in others the function is performed directly by the foreign manufacturer who may deal directly with domestic retailers.

The organisation of the distribution trade differs greatly from product to product. For example, in the case of cars the general practice is for a single importer/distributor to handle the sales of a make of cars to all retailers in the Republic. In the case of brown and white electrical goods there was a change in the 1970s from a situation where wholesalers had a significant role to one where the bulk of the distribution was concentrated in the hands of a small number of importer/distributors (MLC Consultants, 1979) as in the motor trade.

Clearly there is great diversity of practice in the sector in Ireland and this should be borne in mind when attempting to reach general conclusions concerning the prospects for the sector after 1992. While the practice in the Republic of Ireland may, in many cases, be similar to that in other member states of the EC, there are frequent exceptions. For example, Guinness Group Sales (Ireland) Ltd. distribute in the Republic through wholesalers whereas in the North of Ireland they distribute directly to the licensed trade (O'Reilly, 1988).

The fact that there is such a variety of practice in the distribution sector across products and across countries suggests that even after 1992 changes may be slow to occur and considerable diversity may still remain. However, the experience of EC entry in some segments of the market, such as brown and white electrical goods (MLH Consultants, 1979), indicates that changes in trade barriers can stimulate significant change in the organisation of national markets over the long term.

Employment and Output

The distribution sector in Ireland accounts for a significant share of total employment (13.5% in 1987) and, as such, is of considerable importance to the economy. As can be seen in Table 1, after some growth in the 1970s, employment has been relatively static in this sector since the beginning of the 1980s.¹ The 1970s were a period of rapid growth in the volume of consumption. At the same time there was a significant rationalisation in the sector, in particular in the retail area. Thus, the relatively slow employment growth reflects a significant rise in productivity in that sector. However, the pattern is rather different in the 1980s. From 1981 to 1987 there was a cumulative rise in the volume of consumption of only 0.6 per cent while the numbers employed in retailing actually rose by 6.8 per cent. However, this rise was probably more

Table 1: *Employment in the Republic of Ireland (thousands)*

	<i>Wholesaling</i>	<i>Retailing</i>
1971	36.856	95.303
1977	42.100	98.300
1979	38.000	107.500
1981	49.028	102.247
1983	43.200	106.700
1984	44.200	107.400
1985	46.800	104.200
1986	45.700	106.400
1987	39.200	109.200

Sources: 1971 and 1981, Census of Ireland. 1977, Census of Distribution. Other Years, Labour Force Survey. (Retailing excludes public houses.)

¹ The numbers employed in the wholesale sector includes the bulk of those who are employed in importing goods.

apparent than real as it reflects an increase in the share of part-time workers in the labour force of this sector. In wholesaling, on the other hand, the numbers employed appear to have fallen by 20 per cent over that same period showing a continued sharp rise in productivity.

International comparisons of employment trends in this sector are particularly difficult because of the high proportion of self-employed and part-time workers. Table 2 presents the best set of comparable data for

Table 2: *Comparison of Number of Employees in Distribution Sector (thousands)*

	<i>Wholesaling</i>				<i>Retailing</i>			
	<i>Ireland</i>	<i>UK</i>	<i>N. Ireland</i>	<i>France</i>	<i>Ireland</i>	<i>UK</i>	<i>N. Ireland</i>	<i>France</i>
1981	44.3	885.2	N.A.	819.1	73.1	2,083.3	NA	1,341.1
1982	NA	892.4	20.0	838.3	NA	2,046.8	41.0	1,332.7
1983	38.0	892.1	21.0	834.2	68.9	2,024.5	42.0	1,346.6
1984	37.1	924.9	21.0	823.7	68.5	2,117.3	42.0	1,350.3
1985	39.2	946.0	20.0	812.9	67.0	2,179.7	42.0	1,331.3
1986	38.3	919.7	19.0	811.8	69.3	2,113.7	42.0	1,327.1

Source: SOEC *Employment and Unemployment*. For Northern Ireland, UK *Statistical Abstract*. For Ireland, 1981, *Census of Population*.

Table 3: *Comparison of Consumption per Person Employed in the Distribution Sector*

	<i>Ireland</i>	<i>France</i>	<i>UK</i>
Consumption IR£m	10,385	286,473	264,640
Employment, Wholesaling			
Thousands	42.1	965.8	NA
Consumption per Person			
Employed IR£m	0.247	0.297	NA
Employment, Retailing			
Thousands	98.3	1589.8	2,326
Consumption per Person			
Employed IR£m	0.106	0.18	0.114

The consumption data have been converted to IR£ using purchasing power parity data for 1985.

Sources: Consumption — OECD National Accounts and *National Income and Expenditure, 1987* for Ireland. Employment data for Ireland for 1985 from the *Labour Force Survey, 1985*; for France for 1982 from Albert J. (1987); for the UK from a *UK Business Monitor, Retailing, 1984*.

for Ireland, the United Kingdom, Northern Ireland, and France. Perforce, the data only cover the number of employees in each sector from 1981 to 1986. However, the trend in employees over time should give some indication of the performance of the distribution sector in Ireland relative to that in other countries. On the basis of these data, the fall in employment in the wholesale sector in Ireland has been greater than that in either the UK as a whole, or locally in Northern Ireland. In France the number of employees in 1986 was down slightly on 1981, in spite of a significant growth in consumption. Thus the pattern of behaviour in Ireland and France was rather similar.

In retailing the experience of the different countries was closer, with little growth in the UK and a limited fall in Ireland and France. Once again the North showed no significant change.

The bulk of the services of the distribution sector are provided to retailers who, in turn, supply consumers. As a result, one possible measure of productivity in the sector is a comparison of the ratio of the value of consumption to numbers employed. In making such a comparison in Table 3, the value of consumption in 1985 has been converted to Irish pounds using purchasing power parity data for that year. As shown in the table there is not a large difference between the figures for France and Ireland for consumption per person in wholesaling. There is a big difference between France on the one hand and Ireland and the UK on the other in terms of the consumption per person employed in retailing. However, the data on margins presented below would suggest that this apparent higher rate of productivity in retailing in France and the UK may not be significant.

Margins

Clearly a vital issue in considering how the distribution sector will fare after 1992 is how competitive it is in terms of the margins which it charges on goods and services. A comparison of margins is also important in understanding the differences between countries in net of tax prices, discussed below in Section 4. However, it is extremely difficult to obtain comparative data in this area. No harmonised statistics have been prepared and, even if such statistics were available, differences in the character and organisation of the different national markets makes comparison very difficult.

For example, recent trends in the retail trade in the UK have been towards greater competition in terms of quality of service (including store refurbishment and redesign) rather than competition on price (Bamfield, 1988). This trend involves higher gross margins than in the early 1980s. However, when comparing the current situation in the UK with that in 1980 or the current situation in other national markets these higher margins do not necessarily mean that the UK is less competitive. Similarly, in France, the role

of retailers who provide a specialised service accounts for much of the diversity of margins within the retail sector (Albert, 1987).

National markets also differ in the extent to which the functions of retailers and wholesalers are integrated. In Ireland the growth of the large supermarket chains, which in many cases deal directly with manufacturers, has resulted in the splitting of the wholesale function between the manufacturer and the retailer. The cost of this function could be expected to lead to higher margins at either (or both) the retail or manufacturing level while resulting in a lower total price to the consumer.

Set out below is a comparison of gross margins at both the retail and the wholesale level. The comparison is handicapped by the fact that the latest figures for Ireland refer to 1977, the beginning of a consumer boom. It could be expected that the prolonged recession of the 1980s would have significantly altered the situation. New data for Ireland are currently being collected but will not be available for at least a year.

As can be seen from Table 4, the gross margin² in food retailing in the Republic in 1977 was lower than that recorded for France in 1978, or the UK for 1984. For supermarkets the Irish margin in 1977 was significantly below that of major food multiples in France in 1978, and was slightly below that of hypermarkets and supermarkets in the recession year of 1982. This suggests, but does not prove, that the retail sector in Ireland is competitive with that in the UK and France.

The contrast is even greater in the case of sales of clothing and footwear. In Ireland in 1977 the gross retail margin was 25.9 per cent whereas the margin in the UK was 40.8 per cent in 1984 and the margin in France in specialist clothing shops was 38.3 per cent in 1980. However, it is clear that much of the variation is due to the way the trade is organised in the three countries. In the case of France the margin quoted is that for specialist clothing shops. The margin in department stores in France in 1980 was 33.4 per cent and in other supermarket type non-specialist shops was 26.7 per cent. Clearly consumer preference in France has resulted in a greater concentration of sales in specialist outlets and the higher margins do not necessarily reflect a lack of competitiveness of French (or UK) retailers. As in the case of food retailing, while these data do not prove that the Irish retailing sector is competitive, they are certainly consistent with such a conclusion.

Data on margins in wholesaling are presented in Table 5. Once again the Irish data are very out of date and are taken at a different stage in the economic cycle than the data for the UK. While the margin in Ireland in 1977 on wholesaling of food and drink was slightly lower than that in the UK in 1985,

2 The gross margin is defined as the difference between the turnover and the purchase price of the goods, all divided by the turnover.

Table 4: *Comparison of Retail Margins in Ireland, France and the UK*

Country	Sector	Year	% Margin
Ireland	Grocery (excl. pubs)	1977	15.1
	Supermarket	1977	15.1
France —	Large Firms	1978	18.9
Food	Small Independents	1978	18.7
	Hypermarkets	1982	16.6
	Supermarkets	1982	15.5
	Local Shops	1982	21.2
	Trad. Independents	1982	20.4
UK	Food	1984	21.3
Ireland	Clothing and Footwear	1977	25.9
France	Specialist Clothing	1980	38.3
	Department Stores	1980	33.4
	Other Large Stores	1980	26.7
UK	Clothing and Footwear	1984	40.8
Ireland	Total Retail	1977	20.3
UK	Total Retail	1977	27.6

Sources: Ireland — *Census of Distribution, 1977*; France — "Commerce en Detail", in *Economie et Statistique*, No. 196, February 1987. Bury (1987); UK — *Business Monitor, Retailing, 1984*, SD025.

Table 5: *Comparison of Wholesale Margins in Ireland and the UK*

Country	Sector	Year	% Margin
Ireland	Food	1977	10.6
	Food & Drink	1977	11.3
	Clothing & Footwear	1977	22.8
	Building Materials	1977	26.3
	Total Wholesaling	1977	16.8
UK	Food & Drink	1985	12.4
	Clothing & Footwear	1985	18.4
	Building Materials	1985	22.2
	Total Wholesaling	1985	13.4

Sources: Ireland — *Census of Distribution, 1977*. UK — *Business Monitor, Wholesaling, 1985*, SDA26.

the margins for clothing and footwear, building materials, and the wholesale sector as a whole were all higher. However, the rise in the sector's labour productivity in the 1980s may mean that it is in a better position to face stiffer competition after 1992. However, given the problems of comparability, discussed above, firm conclusions cannot be drawn from this comparison.

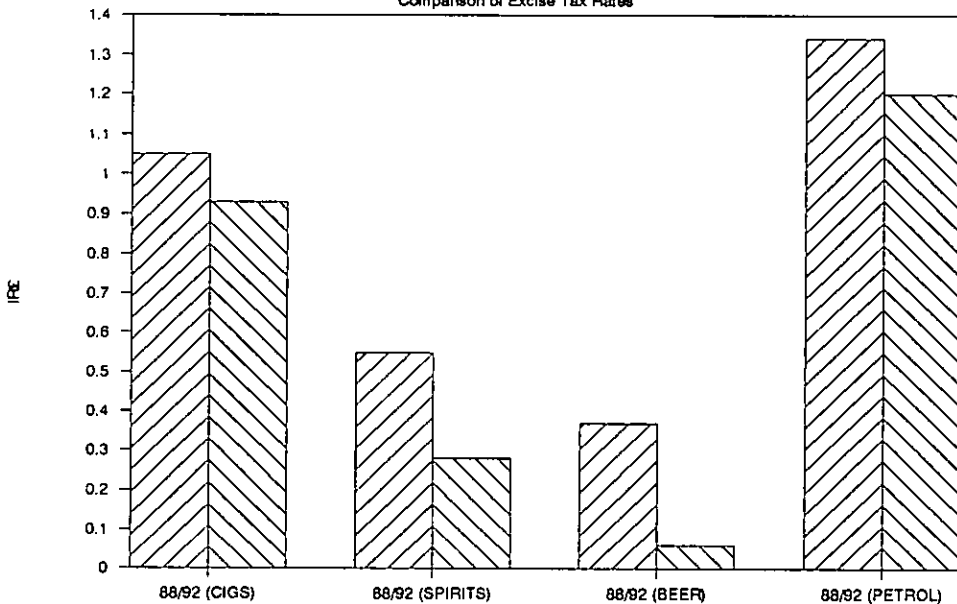
3 The European Commission Proposals

The full ramifications of 1992 for Ireland and the other member states of the EC are still being teased out. However, there are certain aspects of 1992 which will have particular relevance to the distribution sector and these are discussed below.

Taxation

As discussed in an earlier paper (Fitz Gerald, 1986) tax harmonisation is not an end in itself but is generally seen as necessary baggage which must be carried on the way to achieving the wider goals of 1992. The issues involved are not ones of what is, in an economic sense, the best indirect tax system for the EC. It is rather a question of achieving a compromise acceptable to all member states. The process of searching for an agreed set of proposals is still in progress and there are a number of possible variants which may form a basis for a Community-wide agreement.

FIGURE 1
Comparison of Excise Tax Rates



The European Commission have produced a very comprehensive set of proposals on indirect taxation (European Commission, 1987). For VAT they call for a gradual harmonisation so that the standard rate of VAT in all members of the EC would lie in the range 14 per cent to 20 per cent. A special reduced rate would be applicable to food and other essentials. This rate would lie in the range 4 per cent to 9 per cent.

In the field of excise taxes the Commission have put forward a series of proposals which would involve a single rate of excise tax, specified in ECUs, applicable in all member states. The rates of tax proposed by the Commission represent a compromise between the rates currently applicable in the member states. In the case of spirits it is an average of existing rates whereas the proposed rate of tax on wine and beer is arrived at by an alternative compromise formula. Figure 1 sets out a comparison of the rates of excise tax at the end of 1988 and the proposed rates of excise tax on the principle items liable to excise.

These proposals would involve a major reduction in the rate of tax on alcohol in Ireland compared to the present situation. The tax on petrol would also be substantially reduced. In costing the effects of tax harmonisation the Department of Finance has assumed that the excise tax on cars will be abolished. All of the other minor excise taxes which affect trade will also be abolished.

The Department of Finance has estimated that the Commission proposals would involve a loss of £470 million in the year of implementation and £350 million a year thereafter. This loss of revenue arises from the proposed change in excise taxes. The VAT changes would provide a limited offset to the effects of the cut in excise taxes. The estimate of the loss of revenue assumes that Ireland goes to the top of the VAT bands proposed by the Commission, in spite of the fact that the UK is likely to remain at or near the bottom of those bands. As discussed below, such a situation, when combined with open borders, could lead to a much higher loss of revenue than the Department's estimate and major problems for the distribution sector in Ireland. Whatever the eventual loss of revenue, the funding of tax harmonisation clearly poses a major political problem for Ireland.

It should be remembered that these proposals also involve a big increase in taxation on alcohol in a number of member states and, as a result, they pose significant political problems for other governments. This must be borne in mind in considering whether the Commission proposals will actually be adopted. There are a number of alternative approaches to the problem of excise taxes, which are beginning to emerge, whose implications for Ireland need to be considered.

The first of these is the set of proposals from the UK Treasury. These involve

no general agreement on tax harmonisation with a maintenance of limited border controls which could allow the UK (and, presumably, Ireland) to maintain different rates of excise taxes from other members. In the case of other goods there would be no restriction on the flow of goods across borders so that the "market" would decide what divergence in tax rates is feasible. The net effect of such an approach would obviously be that the lowest common denominator in terms of VAT rates would tend to prevail in the Community. The maintenance of even limited economic borders which this approach would imply would obviously call into question many other aspects of 1992.

An alternative suggestion, discussed in *The Economist*³, would also involve a common VAT rate but different excise tax rates across the EC. Instead of maintaining border controls all items sold in a country would have to carry an excise stamp showing that tax had been paid in the jurisdiction in which it is to be sold. Individuals would be allowed to import quantities for their own use ("non-marketable" amounts) without paying additional duty. The advantages and disadvantages of these different approaches are dealt with below.

In addition to the above proposals on indirect taxation, there are ongoing discussions on how excise taxes on motor vehicles will be handled after 1992. While the Department of Finance has assumed in their costings that these taxes will be abolished, there is no certainty that this will be the final outcome. The enforcement of the law on excise taxes on motor vehicles, while facilitated by the existence of border controls, does not depend on them for success. As a result, it is theoretically possible that these taxes could be maintained, though it might well be construed as being contrary to the spirit of 1992. Another possibility would be the replacement of motor vehicle excise duties with a greatly increased initial registration charge for motor vehicles. However, these alternative methods of maintaining tax revenue from motor vehicles have certain disadvantages from the point of view of the distribution sector and the economy as a whole. These potential costs must be offset against the costs of having to find the lost tax revenue from other sources.

Abolition of Economic Borders

While the harmonisation of indirect taxation is very closely related to the abolition of economic borders, an integrated European Market carries its own special implications for the distribution sector. As discussed in *The Economics of 1992*, (Emerson *et al.*, 1988) the abolition of borders will bring significant savings through eliminating the time spent at border crossings and the related paper work which accompanies intracommunity trade. The resulting saving, through reducing the costs of trade, should prove of benefit to many firms which are currently engaged in trade.

3 "Shipwrecking 1992". *The Economist*, September 17 1988.

However, this change will not only affect firms involved in international trade, but all aspects of commercial life. In particular, it will affect the operating environment of many firms in the distribution sector. The ability of consumers to shop in different countries without let or hindrance will obviously affect retailers, not only in border areas, but throughout the country. The ability to import goods without detailed documentation will greatly facilitate retailers who wish to source a range of different products in a different country. The full implications of this change are discussed in Section 5.

Competition Policy

While the discussion of the effects of EC Competition Policy has recently tended to concentrate on large multinational mergers and the world of air transport, competition policy also has major implications for the distribution sector. While block exemptions to the competition regulations have been given to permit manufacturers to continue (or create new) exclusive distribution agreements, these agreements cannot be used to discriminate against purchasers on a geographical basis. For example, the existence of an importer with exclusive rights to distribute in the Republic does not permit a UK importer, with similar exclusive rights for the UK market, to refuse to sell in the UK to a purchaser from the Republic. This provision, combined with the abolition of all border controls, has major implications for the pricing of goods by manufacturers and distributors.

Right of Establishment

In the Republic of Ireland and the United Kingdom there are no special obstacles preventing firms from other countries (or even new domestic firms) entering the retail trade. However, the situation is rather different in France and Italy. In France, under the "loi Royer" of 1973 (Ecalte, 1986) the existing firms in the retail trade can hamper entry of new firms or foreign firms. The position is rather similar in Italy. While it is argued that the distortions involved have not been great, it still poses a problem for any Irish firm wishing to set up in those members of the EC (ibid). Because of the way the barrier to trade is implemented through the planning laws it does not appear to be covered by the Commission proposals for 1992. Clearly if it does pose a barrier to the expansion of Irish firms this problem will have to be tackled. As there are no reciprocal barriers to entry in Ireland it is clearly in the Irish interest to see this particular playing field levelled.

Public Procurement

While entry to the EC in 1973 should, in principle, have prevented the discriminatory purchasing practices by Irish or other member governments,

this rule has been widely ignored. It is no coincidence that few firms manufacturing telecommunications equipment felt it worthwhile to set up in Ireland and lose the advantage of access to other much larger national markets. However, if, as is promised, these practices end in 1992, it will obviously affect the Irish economy. Competition for Irish government contracts will become stiffer while Irish firms will be in a much better position to compete for contracts abroad. This change will affect some firms in the distribution sector though it probably is more important for firms elsewhere in the economy.

The European Monetary System

While there are many other changes which are planned for 1992, the last one we want to refer to is the development of the European Monetary System. The current situation in which Ireland is a member of that system and the UK is not has posed significant problems for the distribution sector in the Republic over the past ten years. If the UK were to remain outside the EMS after 1992 when border controls are abolished, these problems could be multiplied. Whether they would be problems for the distribution trade in the Republic (and possibly France and Belgium) or problems for the distribution trade in Northern Ireland and the United Kingdom would depend on the circumstances which prevail in 1992. This matter is discussed in more detail in Section 5.

4 Pricing in the Irish Market

While tariff barriers between Ireland and the EC were dismantled progressively in the 1970s this did not ensure that prices were identical in different countries. The existence of customs barriers has allowed wide differences in retail prices across national boundaries to persist. The fact that purchasing power parity does not hold between major countries is well established (Frenkel, 1981).

Table 6 sets out the results of a comparison of consumer prices carried out by the Statistical Office of the European Communities (SOEC). The results are based on a detailed study carried out every five years which is revised at more frequent intervals in the light of changes in the consumer price index and exchange rates in each country. For each year the prices in each country are expressed as a percentage of the Irish price level. For example, prices in Denmark in 1975 were 151.9 per cent of the level of prices in Ireland.

The position of Ireland within the EC deteriorated over the period 1975 to 1985. Whereas in 1975 the price level in Ireland was lower than in the 9 other member states, by 1985 it was significantly higher than in Italy, the UK, the Netherlands and Luxembourg. While the position has improved somewhat

Table 6: *International Comparison of Price Levels*

	<i>Ireland = 100</i>				
	<i>1975</i>	<i>1980</i>	<i>1985</i>	<i>1987</i> May	<i>1988</i> June
Denmark	151.9	141.7	126.3	140.6	142.7
Germany	139.5	134.5	108.8	118.3	117.4
France	137.0	128.6	105.0	109.3	109.1
Belgium	134.6	126.2	97.5	106.0	104.2
Netherlands	124.7	122.6	95.0	103.4	102.3
Ireland	100.0	100.0	100.0	100.0	100.0
Italy	108.6	89.3	87.5	94.3	94.7
UK	103.7	115.5	95.0	87.3	93.4
Luxembourg	123.5	115.3	90.0	95.9	93.4
Spain	NA	NA	68.8	70.2	77.1
Greece	NA	85.7	72.5	69.9	72.9
Portugal	NA	NA	57.5	56.0	56.9

Source: SOEC

since 1985, the price level in the UK was still only 93.4 per cent of the Irish price level in June 1988. However, these data make no allowance for differences in rates of indirect taxation and, as a result, are not a direct test of whether purchasing power parity holds.

In the major study by Emerson *et al.*, on the effects of 1992 on the EC the SOEC PPP data were adjusted for tax differences. While this adjustment reduced the measured dispersion of prices, there were still major differences left to be explained by other factors. For consumer goods, excluding energy, the standard deviation for the EC in 1985 was reduced from 19.4 per cent to 15.2 per cent by excluding taxes from measured prices.

In a detailed study of the factors affecting cross-border shopping in Ireland, published in March 1988 (Fitz Gerald, Quinn, Whelan and Williams, 1988), we examined the effects of differences in indirect taxes on prices in Northern Ireland and the Republic. The results suggested that in February 1987, for the basket of goods examined, net of tax prices in the Republic were over 10 per cent higher than in the North. However, as shown in Table 6, the movement in the SOEC purchasing power parity (PPP) data since that date would suggest that much of this difference has since been eliminated. However, it still remains true that for significant periods in the 1980s, the level of net of tax prices in the Republic was different from that in the UK.

The movements in the purchasing power parity data for other countries, which have had minimal changes in their indirect tax systems in recent years,

also indicates that the failure of PPP is not an unusual phenomenon in the Community. For example, the price level in Germany is now 17.4 per cent higher than that in Ireland whereas it was only 8.8 per cent higher in 1985.

The failure of PPP, at least in the short term, may reflect slow adjustment of prices to exchange rate changes; costs of selling in different markets may differ; transport costs to different markets may account for differences in the price of imported goods; margins may differ from country to country. What is clear is that the position of consumers varies significantly from market to market and that the difference in purchasing power is not just affected by variations in rates of indirect taxation. An important part of the benefits of 1992 are forecast to come from the reduction in these price differences. Thus, in considering the effects of the abolition of economic borders, it is important to understand how these net of tax price differences arise and how they can persist in the face of relatively free trade in goods in the EC. The possible reasons for these price differences are many and are discussed below.

Macroeconomic Evidence on Pricing

A large number of studies have been carried out over the last 15 years into the determination of prices in Ireland. The studies carried out in the 1970s showed that Irish prices generally followed closely those in the UK (Geary, 1976; Bradley, 1977). However, since the break in the link with sterling after Ireland joined the EMS in 1979, the situation has changed.

A recent study (Fitz Gerald and Callan, 1989) indicates that the output price of manufacturing industry is still determined in the long run by movements in prices in the rest of the world, primarily by prices in Germany and the UK. However, it also showed that exchange rate changes led to a significant temporary divergence of Irish output prices from those in the UK and Germany. This *temporary* divergence could persist for a number of years as firms are slow to adjust their prices. When the same model was applied to data for output prices in Belgium similar results were obtained indicating that the behaviour of firms in Ireland is by no means abnormal.

The results presented in our study of cross-border shopping suggest that consumer prices behave in a similar fashion to wholesale prices, showing a slow adjustment to exchange rate changes. Taken together, these results indicate that a very important reason for the difference in the price of similar goods across the EC at any point in time is the slow response of prices to exchange rate changes. However, it is also clear that exchange rate changes are not the only factor and that microeconomic evidence is required to fully understand the reasons why purchasing power parity does not hold at any given point in time.

Microeconomic Evidence on Pricing

There is a range of different possible explanations for the difference in prices between EC members. Two of these reasons, differences in indirect taxes and exchange rate changes, have already been discussed using evidence from macroeconomic studies. Additional possible reasons are the cost of transporting goods from the manufacturer to where they are finally consumed; differences in the efficiency with which they are distributed (distribution margins) in different countries; market differentiation on the part of manufacturers.

The evidence presented in the report of the *Irish Restrictive Practices Commission* (O'Reilly, 1988) tends to confirm the macroeconomic evidence concerning the importance of slow adjustments of manufacturers' prices to exchange rates. For example, in 1987, at a time when the Irish Pound was worth between 90 and 95 pence sterling, Irish Distillers gave evidence to the Commission that "the company's N.I. price list was fixed in 1986 on a projected value of the Irish Pound to sterling of 85p ...". Their projection was very accurate!

For Ireland, being an island and a peripheral member of the EC, it is to be expected that the costs of transporting goods to or from markets or producers in continental Europe will be higher than for countries located at the centre of the EC. The evidence collected by the CII suggests that for firms operating in Ireland the transport cost of exporting goods accounts for about 9 per cent of the final price (Confederation of Irish Industry, 1988). For similar firms in the heart of the Community the equivalent figure for transport costs is about 5 per cent. This would indicate that Irish firms are at a 4 per cent cost disadvantage.

In the report of the *Irish Restrictive Practices Commission* (O'Reilly, 1988) the issue of the freight differential arising from the cost of transporting goods from the UK to the Republic was examined. It was stated that "the freight differential depends on many different factors and costs of 1 per cent to 7 per cent of the product selling price were mentioned. The most commonly mentioned figure was 5 per cent". Thus it might be expected that if the ex factory price of goods produced in the UK were the same for purchasers from the Republic as for purchasers from Great Britain, then the delivered price in the Republic would be 5 per cent higher than the delivered price in the UK. However, the evidence in that report also suggested that in the case of the North of Ireland that margin was, in some cases, absorbed by the manufacturer, resulting in significant differences in the net of tax delivery price on either side of the border.

It is very difficult from the data available to come to firm conclusions about the competitiveness of the Irish distribution sector when compared with that in other countries. However, the data discussed in Section 2 do suggest that the retail margin in Ireland in 1977 was, if anything, below that prevailing in

France and the UK. It certainly does not suggest that inefficiency in the retail sector could account for the higher net of tax prices observed in the Republic.

The data in Section 2 also suggested that the wholesale margin in Ireland in 1977 was in some cases higher than in the UK. Once again the comparability of these data is seriously open to question. In addition, the very large fall in employment in the sector in the 1980s, documented above, could well have altered this picture.

As already mentioned, the comparability of the data from different countries is significantly affected by differences in the way the trade is organised. The degree of integration of the distribution process, in particular the extent to which retailers deal directly with manufacturers, differs over time, and differs from country to country, and from product to product. There is evidence of a trend over the last 15 years in Ireland for the wholesaler to be left out of the distribution chain. In the case of white goods this was apparent in the 1970s (MHL Consultants, 1979). In the grocery trade the *Restrictive Practices Commission* (O'Reilly, 1987) calculate that between 1979 and 1985 the value of sales by wholesalers grew by only 112 per cent while the retail sales index grew by 141 per cent and the value of sales by multiples rose by 233 per cent. In many cases the multiples deal directly with manufacturers. However, there is some evidence that the decline of the wholesaler may have been halted as the share of the multiples in total trade stabilises.

In their 1988 Report the *Commission* quote the Guinness Group as explaining part of the higher net of tax price for beer in the Republic as being due to less efficient distribution than in the North. In Northern Ireland they distribute directly to the retail trade whereas in the Republic they distribute through wholesalers.

A final possibility, on which there is little evidence, is the role in Ireland of importers in the distribution chain. Because of the small size of the Irish market the role of importers may be similar to that of wholesalers in other larger markets. However, because of the prevalence of exclusive import agreements, these agents may be subject to less competition than their wholesale counterparts in the UK or France. In other cases, where the manufacturer may deal directly with retailers in larger markets, they are forced by the existence of borders and a sea barrier to deal through importers in Ireland. The existence of such an additional link in the distribution chain, with margins of up to 30 per cent, could add to costs and retail prices.

Taking the last of the possible reasons for higher net of tax prices in Ireland, it has long been the practice for firms to charge different prices in different markets. Pricing is determined by the precise conditions in each market and the degree of market segmentation. This situation applies not just for sales of goods

to different countries but also for sales within countries. For example, a study of pricing by firms in the US, Germany and Japan (Greenhut, 1981) found that price discrimination within their national markets was the norm for firms in all three countries.

However, the existence of economic borders placing obstacles, albeit limited, in the path of consumers and distributors seeking supplies in other countries, clearly increases the possibility of market differentiation compared to the situation in large national markets.

The study undertaken by the *Restrictive Practices Commission* (O'Reilly, 1988) of why prices differed between the North and the Republic in 1987 found that the practice of market differentiation was a significant factor. For example, Irish Sugar, Irish Distillers and the Guinness group gave evidence that the market in the North was more competitive than that in the Republic and that they had to accept lower prices there to protect their market position. While other firms indicated that they charged similar prices north and south of the border, it is clear from the limited sample that market differentiation by manufacturers is important in explaining price differences.

In summary, the evidence on pricing suggests that the higher net of tax prices observed in Ireland in periods in the 1980s were probably primarily due to differences in the price charged by manufacturers in the North and the Republic. While part of this difference can be explained in terms of slow adjustment to exchange rate changes in the 1986-87 period some of it must be attributable to market differentiation by manufacturers. There is little evidence of inefficiency or undue margins at the retail level. Prices were also raised through additional links in the distribution chain arising from the importing function. Problems probably also exist at the wholesale level but, even without 1992, there is a tendency for rationalisation to occur.

5 *The Effects of 1992*

As described in Section 3, the changes which 1992 will bring to the distribution sector will manifest themselves first through their changes in the level of prices facing the different actors in the domestic market — consumers, retailers, wholesalers and importers. However, the initial effects may induce changes in the structure of the sector, changes which will take time to implement, and which may have quite important implications for the future development of the sector. We first discuss how the different possible solutions to the question of tax harmonisation will affect the distribution sector. We then consider the way 1992 will affect prices. Finally we discuss the short-term and the long-term effects on manufacturers, importers, wholesalers, retailers, and consumers.

The Implications of Tax Harmonisation

The Department of Finance, in making their calculations of the revenue cost of the Commission proposals on tax harmonisation, has assumed that Ireland would impose the highest rate of tax in each of the VAT bands in 1992. The UK, on the other hand, is likely to go for the lowest permissible rates. Research conducted by the ESRI for Ireland indicates that, even today, cross-border trade can be very sensitive to price differentials.

When all economic borders are abolished in 1992, the existence of a 5 per cent differential in VAT rates between the North and the Republic could lead to major cross-border flows. While the effects on the trade in groceries may be limited to border areas, for high value items, such as cars, white goods and other consumer durables, the effects on the distribution trade could extend throughout the country.

This potential problem is not unique to Ireland. The Commission has received representations from Alsace-Lorraine seeking narrower VAT bands and current thinking in France appears to be that a tighter range of VAT bands is essential if major trade distortions are to be avoided. If Ireland is to prevent such distortions, under the current Commission proposals, the only solution would be to impose the same VAT rates as in the UK. This would raise the cost to the Irish exchequer of harmonisation to almost double the cost currently quoted by the Department of Finance.

The UK proposals appear to envisage a free for all on VAT while still maintaining economic borders to allow differing rates of excise taxes. The free for all on VAT could pose even worse problems for Ireland than the Commission proposals as there would be a tendency for the lowest VAT rate in the EC to prevail. While the suggestion on maintaining limited economic borders to allow higher excise taxes could substantially mitigate the revenue problems posed for Ireland, it would also defeat the purpose of harmonisation, the abolition of economic borders.

Under the third set of proposals discussed in Section 2, the use of revenue or excise stamps, each country could, in theory, set its own excise taxes. Individual consumers could buy goods liable to excise taxes outside the jurisdiction provided that the quantities were only for their own use. If such a scheme were implemented and Ireland and the UK harmonised their rates of excise tax, it would eliminate the incentive for shopping across the border with the North. However, it would pose very serious problems for Denmark, a high tax country, having a common land border with Germany.

There would obviously still be strict limits on the extent to which excise taxes could vary between Ireland and continental countries. For example, the current difference between rates of tax on alcohol in Ireland and France are such that, under this scheme, it could pay each household to go to France to

buy their annual supply of alcohol. Faced with such incentives, there would be tremendous pressures on legitimate traders to engage in smuggling to try and recapture their disappearing trade. Thus, while such a proposal could reduce the need for harmonisation of excise taxes, and the resulting revenue cost, there would still be a need for a large degree of harmonisation to avoid the distortions discussed above.

The eventual agreement which will be reached on tax harmonisation remains unclear. However, the Commission proposals represent the best basis for reaching a compromise solution. In the rest of this paper we have assumed that these proposals will be implemented in such a way as not to cause major distortions in the distribution trade. Either Ireland will impose rates close enough to UK rates to prevent major cross-border shopping, or else the range of VAT rates permitted will be greatly reduced, increasing rates in the UK as well as reducing rates in Ireland.

1992 and Prices

In considering the effects of 1992 on prices we first consider what would happen if prices did not adjust, leaving significant differences between the North and the Republic (or between any other pair of EC members). As will be seen from the discussion, the consequences of such a failure are so serious that market forces will very rapidly force harmonisation of net of tax prices. As with entry to the EC, some of the adjustment will take place before the end of 1992 (some has already begun), as manufacturers and the distribution sector prepare for the abolition of economic borders.

With the abolition of borders there will be no restriction on consumers shopping North of the border (or on consumers from the North shopping in the Republic). If prices differed significantly between the two jurisdictions after 1992 then there would be major trade flows as consumers travelled to benefit from the price difference. The study by the ESRI of cross-border shopping in Ireland, and another study carried out in 1986 for Denmark (Bygvra, Hansen, Retsad and Soltoft, 1987) show that consumers can travel quite long distances under such circumstances.

If no other changes occurred, retailers in the jurisdiction with the higher price would lose much of their trade. For retailers close to the border or retailers selling certain high value products, such as cars, this loss could be very large. However, retailers would, naturally, react very quickly to such a development. Their logical response would be to seek supplies from North of the border on the same terms as Northern retailers (or vice versa in the case of prices being cheaper in the Republic).

It is at this point that the role of EC competition policy would come into play. If wholesalers or manufacturers refused to supply retailers from outside

the jurisdiction this would be contrary to EC law and the Commission would have to take action. It has already begun taking action in Ireland and elsewhere where manufacturers or distributors have tried discriminating in this way. More active intervention in the period running up to 1992 may be necessary to prevent temporary trade distortions arising as markets adjust to the new circumstances.

The existence of customs barriers, and the related plethora of documentation, effectively prevents retailers at present from adopting this policy. With separate forms to be filled up for each product the cost of customs clearance of small parcels of a wide range of items is prohibitive. However, with the ending of such procedures, the issues which will determine where retailers source their products will be price and convenience.

For wholesalers and importers in the Republic (or in the North) the prospect of losing customers in large numbers to suppliers from the North (Republic) would drive them to seek better terms from manufacturers. However, the position of EC competition law under these circumstances is less clear given the block exemptions allowing exclusive distribution agreements.

Provided that indirect taxes are harmonised, the threat of a process, such as that outlined above, should ensure that retail prices will also be harmonised throughout the EC after 1992. In this case harmonisation does not necessarily mean that prices will be identical but rather that the variation from one regional or national market to another will be limited by the cost of transport for the consumer or retailer. Using conservative assumptions, the EC has estimated that the benefits of the reduction in prices could amount to over 2 per cent of Community GDP (Emerson *et al.*, 1988).

One factor which could complicate this process is the possibility that the UK could remain outside the EMS. In that case exchange rate fluctuations would pose continuing problems. The problems which this could give rise to could be more severe than the potential effects of limited differences in VAT rates. Prices on one or other side of the border would have to adjust extremely rapidly to changes in exchange rates, otherwise there would be large temporary surges of cross-border trade. However, these problems would not just affect the Republic-Northern Ireland border; they would also affect the Dover-Calais border if exchange rate fluctuations along the lines of the last year were experienced. Given the size of the EMS compared to the UK, it is also not clear whether the onus of adjustment would fall on the UK price level or on that in the Republic (and other EMS members).

In the case of goods liable to excise taxes, as the Commission proposals call for excise taxes to be set in ECUs, fluctuations in sterling *vis-a-vis* the EMS would result in the price of the pint changing weekly in pubs in the UK while the price would be stable in EMS members such as the Republic!

Given these problems, it seems likely that the UK will eventually join the EMS. In considering how the harmonisation of prices will affect the distribution sector both in the short and the long term we assume this to be the case.

Manufacturers

While the cost of transportation will still permit some price discrimination by manufacturers after 1992 there will be strict limits on the degree of discrimination between neighbouring markets. For much of Irish industry which produces primarily for the export market, this change may not be serious. It is only if they exploit the possibilities of charging markedly different prices in their different export markets that problems could arise.

However, for certain firms which sell a substantial part of their output on the domestic market, there may be a reduction in profitability. The firms which charge lower prices in the North than on their home market in the Republic, due to the increased competition in the North, will find that the Republic has become part of that "competitive" market.

The problems caused by the creation of a single market will be at least as great for foreign manufacturers. A significant number of UK manufacturers treat the Republic as a foreign market and charge a higher price there than on their home market in the North (O'Reilly, 1988). After 1992 they will have to charge similar prices on either side of the border⁴. They may either decide to treat the Republic as part of the home market or else treat the North, like the Republic, as part of a foreign market.

The question of whether prices will be levelled downwards or upwards in Ireland as a whole is clearly of considerable importance both to consumers in the Republic and consumers in the North. Examples of both approaches to the Irish market are already available. An example of a firm choosing a levelling up in 1987 was Unilever when they attempted to charge higher prices in the North than in the rest of the UK to take account of the higher transport costs in supplying that market. While it seems likely that the tendency to treat the Republic as part of a home UK market may prevail, the eventual result in 1992 will probably be a mixture of the two approaches: the aggregate net of tax price level will rise slightly in the North and fall in the Republic.

As discussed in Section 4, price discrimination between markets by manufacturers is probably the single biggest reason for net of tax prices being higher in the Republic than in the UK. As a result, the effects of 1992 in changing the pricing practices of both domestic manufacturers with large sales on the domestic market, and of the large number of foreign suppliers of our

⁴ Failure to do so would result in retailers taking appropriate evasive action by buying in the cheapest market.

market, will be very important. The longer-term effects of the reduction in industrial profitability which this levelling down of prices in the EC implies is not a question for this paper.

Importers

Currently agents and wholesalers engaging in the import and distribution of goods from abroad are the most vulnerable to change after 1992. For UK firms supplying the Irish market they will find it considerably easier to dispense with agents and deliver direct to retailers. An example of a firm which has moved over to this system is Kelloggs (O'Reilly, 1988). Where firms are already delivering directly to the North it may prove attractive to extend this practice to the market in the Republic.

Where goods are being imported from outside these islands there may be some tendency for the foreign manufacturer to appoint a single distributor to handle both the UK and the Irish market. A single distributor would be in a better position to negotiate lower prices than would an importer handling the market in the Republic alone. Even if the foreign manufacturer did not plan such an outcome, the existence of better terms for larger sales could allow the UK distributor to shave his margins and undercut the importer in the Republic, thus taking over the whole market. The fact that the Irish importer could not, under EC competition policy, prevent Irish retailers from going to the UK (or the North) to obtain better terms available there, together with the absence of border formalities, will make the situation after 1992 different from the past.

For some goods, such as cars, machinery, and consumer durables, where after sales service is important, the existence of a local distributor on this side of the Irish Sea may be necessary due to the cost and time involved in shipping to Britain. However, there may be a trend for rationalisation of the distribution system on this island by the appointment of a single distributor covering the Republic and the North. An example of such a system of distribution is Reynolds Electric who handle the distribution of Amstrad computers for both the North and the Republic. This trend could provide some scope for expansion for certain importers and distributors.

Where the existence of an importer as an additional link in the distribution chain adds significantly to the final price of a product, there may be pressure for change if distribution is handled differently across the border. This applies generally throughout the EC. In the case of the Republic it is likely that the net effect of 1992 will be a significant loss of employment among importers which will only be partly offset by some distributors extending their coverage to take in the North of Ireland market.

Wholesalers

To judge by recent trends in employment, the wholesale distribution sector is already undergoing major rationalisation. The growth in the importance of multiples in the grocery trade, which deal directly with manufacturers, is one factor in this process. The new environment after 1992 will add to the pressures. In some limited cases competition from the UK could pose problems if similar terms are not offered in both jurisdictions. However, because of the prolonged decline in the position of the wholesale sector in the UK, competition from that source will not pose a major problem. More important will be the factors driving the rationalisation of the sector in the Republic. The growth of centralised distribution could provide new impetus to such changes.

In addition, some change is to be expected in border areas in the period after 1992. For example, retailers in Donegal might be supplied from the North rather than, at present, from Dublin. This would be a return to the pre-1922 state of affairs. In addition, the issues affecting importers, discussed above, are also relevant to wholesalers. Where better terms are on offer from wholesalers in the UK, the wholesalers in the Republic will come under pressure. Overall, a continuing rationalisation of this sector can be expected in the period after 1992.

Retailers

As discussed above, there is no evidence that the retail sector in the Republic is inefficient by international standards. However, the possibilities of operating chains of stores in different countries with very much less paperwork than at present could well lead to further rationalisation of this sector. For example, both the Quinnsworth chain in the Republic and Stewarts in the North are owned by the same multinational but they are run as two separate organisations. After 1992 retail chains will be able to source their goods in the country where they are cheapest and supply all their stores from that one source. This could significantly increase their market strength in dealing with producers generally, and with multinationals in particular. In addition, the possibilities for centralised distribution by large firms may be increased by the abolition of economic borders and this may increase the strength of the major players in the retail and wholesale markets.

Such a process of rationalisation is inevitably slow. Firms must move gradually in expanding and take time to digest acquisitions. Thus there will not be an instant change in the retail sector in 1992. This process has been underway for many years and will continue well into the 1990s.

When comparing the Irish retail market with that in the UK, the 1980s has seen a growing number of UK department stores moving into Ireland. It is in the more specialist areas, such as the sale of consumer durables, that large

foreign retailers have been slower to intervene in the Irish market. However, after 1992 it will become much easier for them to move in and manage a limited number of stores from the UK (or elsewhere). The fact that the Irish retail market is likely to be more buoyant than in the 1980s will further encourage such trends (Bradley, Fitz Gerald and Storey, 1987).

A further area where growth is likely to take place after 1992 is the retail sector in border areas of the Republic. In the report on cross-border shopping the ESRI estimated that the loss of trade in border areas amounted to around 10 per cent of local business. Clearly 1992 should end the distortions giving rise to this loss and there should be a significant growth in the retail trade in border counties. To some extent this growth will be at the expense of the retail trade on the other side of the border, in the North.

Overall, the effects of 1992 on the Irish retail trade will be felt more on its organisation than on total employment. There will be a continuation of past trends towards concentration in the industry. While the grocery trade has already experienced this trend, it may have a greater effect in other areas. For Irish firms the aim must be to expand outside the country to benefit from economies of scale. So far most of the movement has been in the other direction.

Consumers

As outlined above, in the short term 1992 should bring significant benefits to consumers in the Republic over and above the effects arising directly from tax harmonisation. In cases where net of tax prices are higher than in the UK there should be a tendency for a reduction or an elimination of the difference. However, the cost of transport will still allow, and in many cases necessitate, slightly higher prices than in Britain.

For consumers in Northern Ireland the situation is less clearcut as 1992 may result in the price of some goods being raised to take account of the cost of transport, a cost which is currently being absorbed by the producers and distributors. While there may be some offset arising from the general reduction in the Community price level, (Emerson, *et al.*, 1988), because the UK appears from the PPP data to be already one of the most competitive markets in the Community, the scope for this will be limited.

The possibility of shopping in other countries without restriction, while attractive to tourists, will not confer additional benefits on consumers if prices are harmonised as envisaged above. For consumers in border areas of all member states convenience will be the primary factor giving rise to cross-border shopping. In border areas of the Republic this could result in some limited change in the pattern of trade.

6 *Conclusions*

For the smooth transition by the distribution sector to a single European market after 1992 three preconditions must be met.

First, the form of tax harmonisation finally agreed on must be such that the distribution sector in the Republic is not put at a significant disadvantage compared to the trade in the UK. This requirement calls for somewhat smaller differences in VAT rates than are currently envisaged.

Secondly, the problems posed by the continuation of the current uncertain exchange rate relationship between the UK and the EMS must be tackled. Failure to do so could affect the stability of the post-1992 market in both the Republic and the UK.

Thirdly, competition policy will have to be strictly enforced to ensure that consumers and retailers in Ireland, or other EC members, are treated on an equal basis. Failure to ensure a level playing field could severely affect the pattern of trade in Ireland and other member states. There may be need for additional EC legislation to deal with other problems, such as the restrictions on freedom of entry to the retail market in France and Italy.

The effects of 1992 on the distribution sector will arise, initially, from its effects in promoting the harmonisation of prices in the EC. In the longer term the change in prices and the abolition of borders may lead to a reorganisation of the sector in Ireland and elsewhere.

For manufacturers, their scope for price discrimination between national markets will be greatly curtailed. This will reduce profitability for those firms affected. In the case of Ireland, because of the openness of the industrial sector, this change may not be very serious. However, we stand to benefit from any squeezing of the profit margins of foreign suppliers, with a consequential reduction in the price of imports.

The major area in the distribution sector where 1992 can be expected to lead to reorganisation and a loss of employment is among importers/wholesalers. They will come under pressure from a number of directions: the possible development of centralised distribution; the increased tendency for retailers to deal directly with producers; a tendency for Ireland and the UK to be treated as a single unit for distribution purposes and serviced from the UK. Firms engaged in the distribution of goods requiring after sales service may be insulated from this by the transport cost of servicing the Irish market from Britain. However, there will be a tendency for the island to be treated as a unit for distribution of such goods and this may provide scope for some firms in Dublin (or Belfast) to expand to cover the whole island.

For the retail sector the initial impact of 1992 should be confined to a harmonisation of prices, while not directly affecting profit margins. However,

the increased scope for multinational retailing operations should see a continuation of the trends which have been apparent in some areas of retailing over the last twenty years. These changes will take time and will not occur suddenly at the end of 1992.

For consumers in the Republic 1992 should mean some limited reduction in net of tax prices over and above the effects of tax harmonisation. For Northern consumers the situation is less clearcut with net of tax prices rising, in some cases, to take account of transport costs.

Taken together the level of employment in distribution will probably be adversely affected in the short term due to a shake out among importers and wholesalers. The benefits to the distribution sector in the border trade from the ending of current distortions will go some way to offsetting this. In the longer term, the progress of the distribution sector will depend on the added dynamism which 1992 is expected to provide to the EC as a whole.

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THE ECONOMICS OF 1992 : AGRICULTURE AND FOOD

ALAN MATTHEWS*

1. Introduction

Five significant factors will influence the Irish agricultural and food industries' environment over the next five years:

- (a) the performance of the global economy and the extent to which economic imbalances between the major trading blocs can be reduced. These global factors will have implications for the rate of economic growth of major export markets, interest rates and relative exchange rate levels (particularly the key ECU/US dollar rate which is a major determinant of the cost of providing agricultural price support within the EC).
- (b) the outcome of the agricultural talks in the Uruguay Round of GATT negotiations. The mid-term agreement reached in Geneva in April 1989 will have little immediate impact on EC agriculture. However, the contracting parties, including the EC, have agreed to the long-term objective of "substantial progressive reductions in agricultural support and protection sustained over an agreed period of time". Participants are required to advance by December 1989 detailed proposals for the achievement of this long-term objective, and implementation of the first tranche of agreed commitments on the long-term reform programme will take place in 1991.
- (c) the operation of the latest package of CAP reforms, known as stabilisers, together with the financial guidelines for agricultural spending agreed at the February 1988 Brussels European Council. The intent of these reforms is to provide for mandatory reductions in price support once production ceilings are breached.
- (d) the general impact of the 1992 project to remove frontier, fiscal and other barriers to trade within the Community of Twelve on the cost and marketing environment, matters which have been discussed by other speakers at this symposium.

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(c) the measures specific to the agricultural and food industries in the 1992 programme. These measures are the focus of this paper. The major areas likely to be affected include:

- animal and plant health regulations
- the agri-monetary system
- the implications of VAT harmonisation for agriculture
- quota regimes in agriculture
- food law
- rural development and the use of the structural funds.

These changes should be evaluated in the context of the other factors mentioned above likely to have a major influence on the food and agricultural industries in the coming years.

2 Animal and Plant Health Regulations

The complexity of this area is indicated by the fact that, of the 300 measures envisaged in the 1985 White Paper, no less than 74 concerned veterinary and phytosanitary regulations. Ireland has strict controls on the import of plants and animals to maintain its relatively good disease-free status. Already these controls have been relaxed compared to the period prior to EC membership. For example, the blanket ban on imports on animals and meat no longer applies. Disease-free status confers benefits in eliminating the need for expenditure on the control/eradication of certain diseases, and in ensuring access to certain markets for our major agricultural exports. The dismantling of border posts will mean that checks on animal and plant health can no longer be applied at frontiers. This raises questions about how health checks will be enforced, what provisions will be made to prevent the spread of serious diseases, and whether this country will continue to be able to prevent the import of plants or animals where a serious disease risk is attached.

In the case of animal health, it is proposed, initially, to transfer inland the controls concerning intra-Community trade, and to step up common actions to eliminate diseases such as swine fever, tuberculosis, brucellosis and leukosis. Health checks will still be conducted, but at source rather than at frontier posts. The role of the veterinary authorities in the receiving country will be confined to the verification of the necessary certificates at the point of destination. Barriers to prevent the spread of serious disease will still be necessary, but are likely to be based on the concept of disease-free regions, areas or herds. Considerable mutual confidence and trust in the effectiveness of the veterinary services in other member states will be necessary for the successful operation of this system. Much work remains to be done both to determine how detailed

controls on animal movement would be applied and on the documentation which will be required.

Ireland's aim will be to try to ensure that the attainment of a common high animal and plant health status throughout the Community will be a prerequisite to freer trade in these products. Although intensified actions have been taken to eradicate diseases in other member states, and to confine outbreaks when they occur, it is a moot point whether sufficient progress will have been made by 1992 to remove Irish reservations in this area. There are two safeguards written into the Single European Act. With regard to the approximation of standards affecting health, the Commission in its proposals must take as a base a high level of protection. Furthermore, a country's right to take national measures it considers justified on the grounds of major needs as set out in Article 36 of the EC Treaty, which include the protection of animal and plant health, is not affected by the Act. It is one of the few remaining areas where unanimity is still required.

A Community plant health regime already exists, but will need to be amended to take account of the abolition of frontier controls. The objectives of a new regime have been set out in the Commission document "A new strategy in the field of plant health" (COM(87)97). The main ideas include the establishment of common Community plant health standards, inspection at source and at external borders (in the case of third country imports), and the issuance of a "plant passport" which would allow free marketing throughout the Community of products meeting these standards.

Other areas where technical standards will be harmonised include the permitted use of drugs, implants and other pharmaceutical products, residue tolerance levels, seed regulation, and the marketing and registration of plant protection products. Standards are also envisaged in the environmental area relating to animal welfare and waste disposal. While these regulations will impact on producer profitability, they will also ensure common conditions of competition for agricultural products across the Community.

3 The Agri-monetary System

For agriculturalists, there is a certain irony in the "1992" programme given that the idea of a single market (along with Community preference and financial solidarity) was explicitly one of the three original principles behind the Common Agricultural Policy. Unfortunately, the Community's market for agricultural products remained fragmented because of the unwillingness of governments to face up to the consequences of currency realignments for domestic agricultural prices. National support prices, when converted into ECU at market exchange rates, can differ significantly by country and by

product. At end December 1987, the highest support price levels on average for all products prevailed in Germany and the Netherlands (7 per cent above the Community's effective average) and the lowest prices prevailed in the United Kingdom and Greece (12 per cent and 38 per cent respectively below the Community average). Inter-country price differentials for individual products are even more striking. In the case of cereals, for example, support prices in Germany were 8 per cent higher than in France and Ireland, 26 per cent higher than in the United Kingdom and 64 per cent above the Greek level (Commission, 1988). In order to sustain these different price levels, border taxes and subsidies known as monetary compensatory amounts must be applied.

Monetary Compensatory Amounts (MCAs) are incompatible with the elimination of internal market frontiers, and their abolition would generally be welcomed by Irish agriculture and food manufacturers. The costs of the MCA system include administration and compliance costs, the costs of trade distortion arising from incomplete coverage and the use of inaccurate coefficients for fixing MCAs on derived or processed products, the uncertainty caused by the incentives to smuggle livestock across the land border with Northern Ireland, and the fundamental anomaly whereby countries with negative MCAs on farm products (which has always been Ireland's experience in the past) suffer a competitive disadvantage compared to countries with revaluing currencies because farm inputs are excluded from the system (devaluation raises the cost of farm inputs immediately while, because of the green money system, compensation through higher product prices is delayed). The one potentially negative feature might be the loss of farm price increases due to the operation of the "switchover system" introduced into the agrimonetary arrangements in 1984.

This system has been an important source of nominal price increases to Irish farmers in the past four years, at a time when nominal prices in ECU terms have been held virtually constant (Table 1). Under this system monetary gaps are redefined as the difference between "green" and "green central" rates, where previously they were determined by the difference between the green rate and the national central rate per ECU. Initially, in 1984, the green central rate was made equivalent to about 103 per cent of the national central rate per ECU. This enabled countries with positive MCAs to reduce those MCAs by 3 per cent without causing any reduction in prices in national currency terms to their own farmers. Other countries had their negative MCAs increased by 3 per cent, which allowed them a national price increase in national currencies by that amount. The Council also decided that in future the green central rates should all be changed in accordance with the highest percentage appreciation of any currency following an EMS realignment. This prevents the development

of new positive MCAs, but at the cost of creating additional negative MCAs. Experience shows, however, that there is much less objection to removing negative MCAs compared to positive MCAs. At present the correction or switchover coefficient which defines the green ECU means that the value of the latter is now 13.7 per cent above the value of the real ECU.

It must be recognised that, for those countries within the Exchange Rate Mechanism (ERM) of the European Monetary System, monetary gaps have now virtually disappeared. Agreement was reached at the 1987/88 farm price review on a timetable to dismantle newly-created monetary gaps (see Reg. (EEC) No. 3578/88). Subsequently, agreement was also reached to phase out the stock of existing negative MCAs in four stages up to 1992.

Table 1: *Changes in various price indices, 1984-87*

	1984	1985	1986 per cent	1987	Total change 1984-87
EC nominal support prices (ECU)	-0.4	0.1	-0.3	-0.2	-0.8
Irish nominal support prices (Irish pounds) ¹	3.0	0.1	2.8	5.8	12.1
Irish nominal producer prices (Irish pounds)	3.0	-2.7	-0.3	4.1	4.0
Irish real producer prices (Irish pounds)	-5.2	-7.7	-4.0	1.0	-15.2

1 Calculated from the change in EC nominal support prices by adding the percentage green rate change between April and April of each year.

Source: *Agricultural Situation in the Community*.

There still remains a question as to what arrangements will apply after 1992. One alternative is to abolish the system of green rates altogether. This would leave agricultural markets to operate like any other, on the basis of market exchange rates for currencies. Support prices would vary in national currency as exchange rates between national currencies and the ECU fluctuated. While exchange rates within the EMS have been relatively stable in the last two years, the liberalisation of capital movements between the major EMS countries after 1990 could lead to increased realignments in the absence of closer monetary co-ordination. Whether member states would be willing to accept the implied instability in their agricultural prices is an uncertain issue. The weakening of the intervention system means that there is now a less direct relationship

between changes in support and market prices than was the case before.

If governments feel it remains necessary to phase in the consequences of exchange rate changes for agricultural prices more gradually, then the other alternative would be to keep green rates but to establish limits to the amount by which they would be permitted to vary from central or market rates before being brought back into line by devaluation or revaluation as necessary. The MCAs would no longer apply, but green rates could differ from market rates up to a fixed amount. Under the existing system, monetary gaps of up to 2 per cent can exist without the introduction of MCAs, due to the operation of the so-called neutral margin and the "de minimis" rule. This neutral margin, or the zone in which MCAs would not apply, could be increased to 5 per cent or even 10 per cent, as indeed the Commission itself suggested in its proposals for the 1987/88 price review. The resulting monetary gaps could then be eliminated more gradually over time.

If green rates are kept in some form or other, then a view must also be taken on the continuation of the switchover system. If the arrangement is continued, then a realignment will continue to permit larger green rate devaluations in all countries except that with the largest appreciation in its currency value, and thus higher nominal farm price increases, than would otherwise be the case. These increases would make the job of market management both more difficult and more unpredictable, particularly in circumstances where the agricultural spending threshold was binding. If, on the other hand, the Council decided to discontinue the switchover arrangement, then the potential for price increases in countries with depreciating currencies would be smaller, and decreases in farm prices in nominal terms would occur in countries with appreciating currencies. Whether German farmers would be prepared to live with this is a moot point.

It might be argued that, in the absence of the switchover system, ECU price increases would be more generous.¹ However, it is hard to believe that the EC would have increased nominal ECU prices by the more than 13 per cent in the past four years which would have been required to produce the same level of national price increases in the absence of the switchover system. While there is undoubtedly some relationship between the size of the percentage ECU increase agreed at the annual price reviews and the value of the ECU in which these price increases are denominated, the degree of substitutability is imperfect. The abolition of the switchover system, therefore, would mean lower price increases for Irish farmers in the future than they might otherwise expect, if exchange rate realignments in the future followed the same pattern as in the

¹ In the 1988 dismantling Regulation, it is intended that the first 25 per cent dismantling of artificial monetary gaps created by the switchover system would be accompanied by a similar reduction in Community prices expressed in ECU.

past. Even if Ireland were to follow a "hard currency" policy and attempt to maintain parity with the DM in the future, the continuation of the switchover system would imply smaller decreases in nominal support prices (because of the 25 per cent rule mentioned in footnote 1) than would be the case if the system is removed.

The Commission's views on the future of the agrimonetary system are expected late in 1989.

4 VAT Harmonisation

The Commission's proposals for VAT include a harmonised VAT base across the Community, a two-rate structure including a low rate between 4 and 9 per cent and a standard rate between 14 and 20 per cent, and certain administrative changes consequent on the removal of customs frontiers. On the assumption that the Irish government will opt for a low rate of 5 per cent and a standard rate of 20 per cent within these limits, then the VAT structure on farm inputs will change as follows:

Table 2: *Possible Changes in VAT on Farm Inputs Following 1992*

	<i>1988 Rates</i>	<i>Likely 1993 Rates</i>
Feeding stuffs	0	5
Fertilisers	0	5
Seeds	0	5
Red diesel	10	20
White diesel and lubricants	25	20
Petrol (non-deductible)	25	20
Electricity	5	5
Repairs by registered garages	10	20
Spare parts (DIY)	25	20
Building and construction work	10	20
Agricultural services	10	20
Transport charges	25	20
Veterinary medicines (oral)	0	5
Veterinary medicines (non-oral)	25	5
Crop protection inputs	25	20
Other minor inputs	25	20
Farm machinery and equipment	25	20
Land improvement	10	20
Farm buildings	10	20

Source: Lucey, C. (1988), *Guide to the European Single Market: Implications for Farmers, the Food Industry and the Irish Economy*, Dublin, Irish Farmers' Association.

Value Added Tax is not a tax borne by producers. Ireland, along with most other EC countries, operates a flat-rate refund system for non-registered farmers (the great majority) designed to compensate them for the VAT paid on their inputs. In practice, the rate of refund paid is a budgetary decision. Before the 1989 Budget Irish farmers argued that the appropriate rate of refund should have been 2.4 per cent rather than the 1.4 per cent then paid, and in the Budget the refund rate was increased to 2.0 per cent. On the assumption that the flat-rate system will continue under the post-1992 regime, it is clear from the table that the appropriate refund will increase after 1992, to about 5 per cent in 1993 according to the IFA calculations. More controversially, the IFA also calls for the harmonisation of flat-rate refunds across the Community. The motive for this is clear; to prevent some governments from using the refund mechanism as a source of hidden taxation, and others from using the system to provide income compensation to their farmers. However, it is hard to see how an objective calculation of VAT refunds across the Community would result in the same rate of refund for each country, given differences in the structure of inputs and output, in the rate of VAT on inputs and in the proportion of registered to unregistered farmers.

Kearney and Boyle (1988) point out that the differential impact on farm input costs, even combined with an increase in the average flat-rate refund, will have differential effects on farm incomes as well as resource allocation effects. More intensive farming systems such as dairying will lose out compared to cattle and drystock farms. Kearney and Boyle estimate that input consumption could fall by between 1 and 2 per cent and that output could fall by between 0.5 and 1.5 per cent, given the new price relativities.

The demand for food may also be affected if VAT is levied on food, as required in the original Commission proposals. As these proposals may undergo further revision, this impact is unclear at this stage. At farm gate level the effect is unlikely to be very large, but it could be important for particular sectors of the food processing industry facing a price-sensitive demand for their products.

5 Quota Regimes

The common sugar market regime has been based on a quota system since its inception, and milk production in the Community has been governed by quotas since 1984. Quantitative restrictions on production contradict the spirit of the single market principle of 1992, although they have played an important role in limiting the budgetary cost of agricultural price support. Because they are not administered through border controls, however, there is no formal reason why they cannot be continued beyond 1992.

There is as yet no indication of the Commission's attitude to agricultural quotas after 1992. It is obliged to present a report on the operation of the milk quota system before the end of March, 1991. The removal of both the sugar and milk quota regimes would have to be accompanied by drastic price reductions if market balance was to be sustained.

The Commission's report on milk quotas may confine itself to proposals to make the quota system more flexible, for example, by detaching quotas from land, or by permitting the transfer of quotas across national boundaries. If quotas were freely tradable, it is a moot point whether the milk quota would be bought into or sold out of Ireland. The relative prices paid for quota in different European countries at the moment may not be the best guide to future trends because of the different market regulations in each country.

6 *Food Law*

The food industry is subject to detailed regulation covering many different aspects — content, denomination, additives, packaging, labelling, time-dating, treatment processing, storage, etc. Because decisions on these matters have been taken at national level in the past resulting in different national rules, the European market is enormously fragmented. The fact that trade in processed foods accounts for only some 6 per cent of Community consumption has been attributed to this fragmentation (Garvey, 1988). The food industry is one Irish industrial sector where the removal of technical barriers should open increased export opportunities. According to research undertaken for the Cecchini Report (Emerson, *et al.*, 1988) the removal of non-tariff barriers in food processing could add 1–2 per cent to the industry's turnover or 2–3 per cent to the industry's value added. The major savings will accrue from the use of vegetable fats in chocolate and ice cream and common wheat in pasta.

In the longer term, the increased competition in the internal market could lead to significant restructuring of the food industry on a European scale. The European food industry is very fragmented, particularly in comparison to US food firms. For example, of the top 45 EC-based food companies, only 10 per cent are represented in all of the five largest EC country markets. About half of the top 45 companies are present in only one or two of the EC's largest countries (Lucey, 1988). Until now, with some obvious exceptions, Europe's food companies have been largely home-market based. The run-up to 1992 is likely to see a major consolidation of these firms, a process already evident from the business pages of the newspapers.

Earlier Community efforts at food law harmonisation were based on a non-selective approach in which the Community attempted to formulate

common rules not only where health and safety aspects of food law were concerned but also for food composition. Food recipe laws are more common on the continent where food purity standards have been valued more highly than in the Anglo-Saxon legal environment where the emphasis has been on providing the consumer with sufficient information on the packet to enable him or her to make up their own mind. Progress was painfully slow until the landmark Cassis de Dijon decision by the European Court of Justice in 1979. In this case the European Court ruled that West Germany could not keep the crimson Gallic concoction away from its tipplers simply because it did not meet the local definition of a liqueur. Similar decisions have followed. In 1987 the Bonn Government was overruled in trying to persuade the Court that the 470-year old Bavarian Reinheitsgebot law banning the use of additives in German beer could be used to stop the import of foreign beers. Another case in 1988 concerned pasta, which in Italy can only be made from hard or durum wheat. West Germany wanted to export pasta made of a mixture of soft and hard wheat, and the Court dismissed Italian claims that it was prejudicial to human health and safety and likely to mislead the consumer.

The Cassis de Dijon decision opened the way to an alternative approach to freeing trade in processed foods (and, of course, in other sectors as well) through the mutual recognition of standards rather than their harmonisation. The Court decision means that any product made and legally marketed in one member state should be allowed free circulation in another, unless restrictions are justified by considerations of public health and safety, fair trading or consumer protection. Subsequent judgments of the Court make clear that such restrictions must be proportional to the risk involved (Garvey 1988). This new approach to harmonisation was adopted and set out in a Communication to the Council and the European Parliament entitled "Completion of the Internal Market : Community legislation on foodstuffs" published at the end of 1985 (COM(85)603). Under this new approach Community-inspired harmonisation is restricted to so-called horizontal directives laying down common minimum standards in the areas of public health, consumer protection, fair trading and food inspection. Under these headings proposals have been or will be made under the following headings:

- food additives
- materials in contact with food
- foods for particular nutritional uses
- processing techniques
- labelling
- nutrition labelling
- food inspection
- new foods

This new approach to harmonisation in the food area inspires three comments. First, Pitts and Simms (1988) make the point that there is nothing automatic about the mutual recognition of standards. They point out that the Cassis de Dijon decision is now nearly ten years old, yet individual cases must still be fought through the courts to get the principle accepted (the prohibition enforced by several countries on dairy substitutes being one example). Progress in opening access may yet be slow and tortuous.

Second, the establishment of Community standards for intra Community trade will inevitably impact on third country trade. A topical example is the current dispute between the US and the EC over the EC's prohibition of meat imports unless they can be shown to have been produced without the use of hormones banned within the EC.

Third, the mutual recognition of standards introduces a new element into the integrated market, namely, the possibility of competition between regulatory regimes. Under the new approach a country can, if it wishes, impose higher restrictions on its own manufacturers than Community legislation requires, although it cannot exclude products from other countries with lower standards. Of course, a country imposing higher standards on its own manufacturers will place them at a cost disadvantage *vis-a-vis* their competitors. A Danish law requiring a larger space for laying birds in intensive egg production, for example, has resulted in Denmark becoming a net importer of eggs for the first time in its history. The Danes found they could not recoup the cost of higher environmental standards in the price charged for their eggs. Mutual recognition of standards is not only about harmonisation but also about deregulation, and there will be very strong pressures to push standards towards the lowest common denominator. While food products meeting higher standards might be expected to obtain a price premium, this may not be sufficient to cover any additional costs incurred, as in the Danish eggs case. This could have important implications for Ireland's attempt to project itself as a "pure food producer" if this project requires the imposition of higher environmental and other standards than our competitors.

Worries on this point were expressed in a Memorandum from the French Government to the Commission at the end of 1988. It expressed concern that the principle of free movement of foodstuffs combined, in certain sectors, with unrestricted naming and composition practices, could result in industrial synthetic products displacing agricultural products to an excessive degree thus depriving the latter of their natural outlets and increasing the costs of administering the CAP. The French Government wishes to see less emphasis placed on the mutual recognition principle, and more use made of vertical or product specific harmonisation, together with the recognition of the proprietary name of food specialities and the introduction of a Community

standards policy. A consequence of the mutual recognition principle is likely to be the diminishing importance of food standards legislation and the increasing relevance of information on the label.

For Irish food companies, the problem is how best to respond to the opportunities and challenges 1992 will bring. Developing own brands and taking on major brands in the European market place will be a relative rarity, though own brands may still succeed in niche or regional markets. Coras Trachtála (CTT—Irish Export Board) identify business-to-business strategies as likely to be more successful for most companies. These include selling to caterers, selling ingredients to other manufacturers, selling product to other manufacturers or own label products to supermarkets, and engaging in joint ventures or long-term contracts with other food companies in Europe.

Whichever option is chosen, the logic is for fewer but larger food companies. The food industry will become increasingly concentrated, reducing the number of buyers of farm produce and, in particular geographical regions, possibly eliminating competition. Were this to happen, farmers would find their bargaining power reduced, with lower prices as a result.

7 The EC Structural Funds and Rural Development

The "1992" programme is not only about market liberalisation and the removal of frontiers, but also encompasses measures to help realise the commitment to economic and social cohesion. The reform of the structural funds contained in the framework Regulation on the tasks of the funds (Reg. (EEC) No. 2052/88) is one response to this commitment. A major innovation in the framework regulation is the concentration of fund activities on specific objectives. For Irish rural regions, two of the five Objectives outlined are of particular importance: Objective 1, which gives priority to "promoting the development and structural adjustment of the regions whose development is lagging behind", and Objective 5, which has as its goals

"with a view to reform of the common agricultural policy:

- (a) speeding up the adjustment of agricultural structures, and
- (b) promoting the development of rural areas."

For the record, Objective 2 is to provide support for the conversion of regions, frontier regions or parts of regions seriously affected by industrial decline, Objective 3 is to combat long-term unemployment and Objective 4 is to facilitate the occupational integration of young people.

In turn, each structural fund has a specific set of tasks which underpins one or more of these objectives. The Regional Fund, for example, has the essential

task of providing support for Objectives 1 and 2, as well as participating in operations towards Objective 5(b). The Social Fund will contribute primarily towards Objectives 3 and 4, although it can also support measures for Objectives 1, 2 and 5(b), by providing support for vocational training measures, employment aids and the creation of self-employed activities. The pursuit of Objective 5 is primarily the function of FEOGA Guidance Section, although the other two funds can be called upon for measures designed to promote Objective 5(b), and FEOGA Guidance money can also be used in support of Objective 1.

Because each fund is geared to supporting particular activities, the balance between the funds has important implications for the way EC resources can be used. For example, a larger Social Fund at the Community level will make it easier to obtain funds for training and employment schemes relative to funds for road projects or technological infrastructure development. The proposed commitments and payments from the three structural funds in the 1989 draft budget is shown in Table 3 against the trends in earlier years.

The structural fund expenditure guidelines in the framework Regulation are in terms of commitments. The 9,295 million ECU in commitments for 1989 compares to the 9,000 million ECU target (in 1988 prices) in the framework Regulation, thus building in a reasonable 3.3 per cent margin for inflation. A substantial increase of over one-fifth in both commitments and payments from the funds is proposed for 1989, with FEOGA Guidance expenditure showing

Table 3: *Increases in the EC Structural Funds*

<i>Commitments</i>							
<i>Fund</i>	<i>1986</i>	<i>1987</i>	<i>1988</i>	<i>1989</i>	<i>87/86</i>	<i>88/87</i>	<i>89/88</i>
	<i>million ECUs</i>				<i>Per cent change</i>		
Guidance	854	941	1131	1413	+10.2	+20.2	+25.0
Regional	3328	3662	3684	4495	+10.0	+0.6	+22.0
Social	2523	3524	2866	3387	+39.7	-18.7	+18.2
TOTAL	6705	8126	7680	9295	+21.2	-5.5	+21.0
<i>Payments</i>							
Guidance	727	863	1153	1359	+18.7	+33.5	+18.8
Regional	2484	2535	2980	3920	+2.1	+17.6	+31.5
Social	2321	2715	2600	2950	+17.0	-4.2	+13.5
TOTAL	5532	6114	6733	8239	+10.5	+10.1	+22.4

Source: 1986 figures from Court of Auditors Annual Report (O.J. 25.12.87), other years from 1989 draft budget.

the biggest increase in commitments terms and the Regional Fund showing the biggest increase in payments terms. As Ireland already receives a high proportion of Social Fund spending, and might have difficulty in absorbing further additional funds in this area, the trends shown in the 1989 budget are welcome from Ireland's point of view.

The 1989 draft budget also allocates structural fund spending by Objective as follows:

Objective 1	5,800 million ECU
Objective 2	1,022 million ECU
Objectives 3 and 4	1,250 million ECU
Objective 5(a)	661 million ECU
Objective 5(b)	264 million ECU
Transitional and innovative measures	298 million ECU
TOTAL	9,250 million ECU

Thus almost 63 per cent of the funds available are intended for the priority Objective 1 regions. For lack of data it is not clear if this represents a greater degree of targeting than heretofore.

The extent to which rural regions and rural development will benefit from these additional funds will depend on the uses to which these funds are put. It is relevant here to note that the framework Regulation also introduced a programming approach to the management of EC transfers through the structural funds. This has two main elements. For each Objective for which funding is sought an overall plan setting out priorities in the area, the way in which problems will be tackled, and an indication of the use to be made of assistance available under the funds or from the European Investment Bank must be drawn up. In the case of Objective 1 regions, the overall plan should cover each of the detailed objectives, including actions in connection with agricultural restructuring and the development of rural areas under Objective 5. The Irish Plan was submitted to the Commission in March 1989. Discussions are underway at the time of writing with the Commission to finalise the Community Support Framework by October of this year.

The second element in the programming approach is that applications for assistance are grouped in the form of operational programmes. For Objective 5(b) it is envisaged that the part-financing of national aids will also be an important component. An operational programme is defined as consisting of a series of multiannual measures implemented through recourse to one or more funds or the European Investment Bank. The objectives for the Agriculture and Rural Development programme in the Irish plan (which may later be disaggregated into a series of programmes) include the following:

- the promotion of farm viability, with particular emphasis on the *elimination of farmyard pollution*;
- increased competitiveness in the food processing sector;
- the diversification of farm production;
- encouragement for non-agricultural activities, especially agri-tourism, in rural areas;
- protection of the environment, including support for environmentally-friendly farming practices in ecologically-sensitive areas;
- the development of human resources and the technology base;
- support for farm incomes through increased compensatory payments under the *less favoured areas directive*;
- the further development of forestry and fisheries.

It is proposed to increase annual expenditure on these objectives from £178 million in 1988 to £319 million in 1993 under FEOGA Guidance Section schemes alone, with the ESF making an additional contribution to the training and education objective.

A particular initiative undertaken has been the launch of an Integrated Rural Development Programme has recently been initiated on a pilot basis in eleven districts. It is intended to have a significant input into the new initiatives on *rural development*. Development co-ordinators have been appointed in each of the pilot areas, whose function will be to assist the local community to draw up priorities for their own area and to work towards realising them. It is stressed that the new Programme is not intended to provide additional resources, but to enable communities to make better use of resources already provided under a range of state and Community schemes. A two year timescale is envisaged for the pilot programme, although whether worthwhile results can be drawn after such a short period might be questioned. In any case the lessons from this Programme will not be available until towards the end of the period covered by the National Plan.

8 Conclusion

The "1992" project will have direct implications both for primary agriculture and for the food industry. Among both primary agriculture and traders the disappearance of MCAs will be greeted with relief, though the Irish government will need to take a view on whether it supports the complete elimination of the green money system or the retention of a modified version of it when this issue is raised later in 1989. For the food industry, the removal of regulatory barriers to entry to continental markets will be of some short-term

significance, but its real importance will be the impetus it gives to a process of consolidation and concentration. This will require Irish food companies to think hard about appropriate business strategies in the post-1992 era. For rural areas generally, the increased funding available for rural development will help to diversify the economic base of rural communities. As cautioned at the outset, however, "1992" is only one of a number of influences which are likely to radically alter the environment for Irish agriculture and food industries in the 1990s.

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APPENDIX

THE IMPACT OF THE SWITCHOVER SYSTEM
ON IRISH FARM PRICES

The impact of the new arrangements on Irish price developments is shown in the following example for beef (because of the differentiation of green rates by product since 1987, the figures would be slightly different for other commodities). The period covered is from 1 April 1984 to 1 December 1988. I am grateful to John Kelly of the Central Bank for providing the necessary information.

In April 1984 the Irish green rate was the same as the Irish central rate at 1 ECU = 0.725690 Irish pounds. By December 1988 the Irish central rate had been devalued to 1 ECU = 0.768411. However, the Irish green central rate had been devalued by an even larger amount, to 1 green ECU = 0.873900. The difference between the central and green central rates of 1.137282, known as the correction factor, represents the highest percentage appreciation of any currency within the EMS.

If the Irish green rate had been devalued in line with the green central rate, then the potential devaluation would have been 17.0 per cent ($0.725690/0.873900$) and the potential price increase to Irish farmers 20.4 per cent ($0.873900/0.725690$). This potential price increase is the product of the price increase due to the devaluation of the Irish central rate within the EMS (5.6 per cent) and the operation of the "switchover" system (13.7 per cent). In practice, the Irish green rate has not been devalued fully, and in December 1988 was 1 ECU = 0.844177 Irish pounds. The actual devaluation amounts to 14 per cent and the actual increase in Irish support prices 16.3 per cent over the period. In the absence of the switchover system, the maximum price increase Irish farmers could have expected from agrimonetary factors would have been 5.9 per cent ($0.768411/0.725690$).

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