THE ECONOMIC CONSEQUENCES OF EUROPEAN UNION
A Symposium on Some Policy Aspects

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Price IR£4.00
(Special Rate for Students IR£2.00)

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Printed by Mount Salus Press, Dublin.

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ISBN 0 7070 0080 7

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BACKGROUND

DERMOT SCOTT*

The goal of European Union — either as the culmination of a process of integration, or as a stage in that process — underlies much of post-war western European history. It strongly influenced the establishment of a Community of, now, twelve Member States, bound by the Treaties of Paris and Rome, and by subsequent adjustments to those Treaties. The Member States are bound also by additional policies not foreseen in the Treaties, such as the European Monetary System, and by non-Treaty agreements running parallel to the Treaties, such as European Political Co-operation. Further instruments or policies operate in other spheres and bring together some or all Member States, with or without the co-operation of non-Community countries: Ariane and the European Space Agency, Airbus, the proposed EUREKA programme of high technology research, the COST programme (European co-operation in science and technology) and so forth. There is however a widespread feeling that the Community is not realising its full potential economically or politically, and that its organisational structure and rules are insufficient for the task.

The first elected European Parliament agreed in 1984 by an overwhelming vote that a new Treaty was required. The Draft Treaty which Parliament adopted aimed to update and consolidate the existing legal instruments, provide for further Community policies and impose rules and procedures which would make the institutions more efficient and more decisive. By increasing the powers of the European Parliament, particularly in the legislative process, it also aimed to guarantee the

*The author is an official of the European Parliament secretariat, but the views expressed here are personal and do not commit the Parliament.

democratic nature of the Community and keep its decisions responsive to the will of the European electorate.

A simultaneous concern of the Parliament was the evident disparity between the effect of the oil crisis on Europe and its effect on the USA and Japan. In Europe production stagnated, unemployment grew and inflation persisted, while the USA and Japan experienced economic growth, new job creation and lower inflation. A report commissioned by Parliament (Albert and Ball, 1983) attributed Europe's poor comparative performance to its failure to adjust its living standards and to its failure to act as a coherent economic unit. On the one hand, public sector workers had successfully defended their living standards, while governments had protected those of social welfare recipients, with the burden being financed either by borrowing, often external, or by further taxation. On the other hand, the persistence of non-tariff barriers, the national ambit of public procurement,[1] particularly in the high-technology and related defence sectors, the failure to co-ordinate economic and monetary policies, the duplication of national research programmes, and the consequent failure to reap the economic benefits of a single Community market of 320 million consumers — all these were symptoms of disunion.

Such findings ran counter to the assumptions prevalent up to the mid-1970s, when the Community was praised for its success in reaping the benefits of negative integration — i.e., dismantling national protection through the implementation of the customs union, the adoption of the common external tariff and the fixing of low tariffs *vis-à-vis* third countries — and criticised for its failure to move on to more positive aspects of integration — a common currency, more developed structural policies, and eventual economic and monetary union. The change may have been due to a realisation that the progress of the 1960s had been less effective than was thought at the time, or that shortcomings in the development of the internal market

1. Albert and Ball (*op cit*, p.75) estimate at 40 billion ECU the annual loss to the Community from failure to operate a unified procurement market. They quote a Commission estimate of 12 billion ECU for the annual cost to the Community from the imposition of administrative delays at internal frontiers. Total losses are therefore of the order of 50 billion ECU, or 2 per cent of combined Community GDP, or twice the Community budget.

had been disguised by the underlying economic growth. Another possible explanation is that national authorities had learnt during the 1970s how to circumvent the rules, and that the protectionist impulse induced by the 1973 oil price rise, and the consequent fall in economic activity, had given them the incentive to exploit every possible means of exporting their unemployment.

Whatever the reasons for the change in emphasis, a new set of assumptions concentrated on a two-fold strategy for economic recovery — the creation of a really free and unified internal market, and increased co-operation in new fields. The creation of the free internal market required the abolition of customs formalities within the Community, eventual harmonisation of VAT and corporation taxes, the creation of Community standards, and meanwhile, the immediate mutual recognition of national standards; it also implied action on public procurement, on the market in services, including insurance,and on monetary co-operation. The new fields of co-operation which were most frequently mentioned were the areas of high technology, such as aircraft, space research, electronics and information technology, as well as biotechnology and energy.

These preoccupations were shared by all the Community's institutions. The European Council was calling for measures to reinforce the internal market at Copenhagen in December 1982, for a study of how to abolish all police and customs formalities at internal frontiers (Fontainebleau, June 1984), for European standards (Dublin, December 1984), and for action to achieve a single large market by 1992 (Brussels, March 1985). The European Commission repeatedly echoed this theme, most recently in the 1985 Programme of the incoming Delors Commission, and in the comprehensive White Paper of June 1985, *Completing the Internal Market.* There was of course a recognition that other factors made important contributions to Europe's poor economic performance, whether labour market rigidities, United States policy, or the failure to stage a joint reflationary effort throughout the Community. There was, however, among partisans of different views, a common recognition of the need to improve the effectiveness and scope of the Community.

The impetus for economic recovery and the parallel movement towards political integration produced a powerful combined thrust, with three interconnected requirements:

> Freeing the market requires the demolition of barriers, and poses immense political problems for the governments of the Community, since each barrier presumably protects some entrenched interest group. Removing barriers quickly will require tough, speedy decision making in the Council of Ministers.
>
> Speedy decision making requires at least the limitation of the use, or, more probably, the removal of the veto. Only if the veto is removed can a government honestly tell its interest groups that it has tried to protect them, but been outvoted. Only thus can governments survive the trauma necessary to bring about the free market.
>
> However, it is not sufficient for a government to be able to say it has been outvoted, it must also be able to point to the advantages of the more integrated Community. The medium-term advantages which should flow from a unified market are part of the answer; so, some participants argued, is a commitment by the Community to greater structural action to promote convergence, in other words, to help bring about a general levelling up of the economies of all regions, and to compensation of losers in the transitional period; so also is a general commitment to greater European solidarity.

In this way, proposals for economic, political and institutional reform have gathered pace since the European Council's Solemn Declaration on European Union (1983). The European Parliament's Draft Treaty on European Union was adopted in February 1984. President Mitterrand expressed his support for it in May 1984 and was in turn supported by Chancellor Kohl, while the majority of national parliaments in the Twelve expressed totally or generally favourable reactions. The Fontainebleau summit established the Dooge Committee which reported in March 1985 on lines generally similar to those in the Draft Treaty; and in June 1985, the Milan Summit decided, by a majority vote of seven to three, to establish an intergovernmental conference to consider changes to the Treaties.

Reaction in Ireland to this process has been somewhat guarded. Conferences at the Royal Irish Academy,[2] and at Blarney dealt mainly with political and institutional issues. The Joint Oireachtas Committee's report on the Draft Treaty also concentrated on the veto and on neutrality, but saw abandonment of the veto as a possibility in return for an adequate level of Community solidarity. It also referred to the "considerable economic, social, cultural and political advantages to be gained from a properly functioning European Union", though it expressed some caveats — that the European Union should have sufficient resources, and that these resources should be redistributed to aid economic convergence. Senator Dooge himself was prepared to go along with the entire content of his report, unlike some of his colleagues, except on the issue of defence, where he abstained, and the veto, where he inserted a clarification.

It is appropriate that The Economic and Social Research Institute should organise a symposium to discuss economic issues raised for Ireland by the proposals for European Union. Four papers were given, of which three are published here in a revised and updated form, those on the macroeconomic consequences of completing the market by John Bradley, on the economic implications of tax harmonisation by John FitzGerald, and on subsidiarity, regional development and nation-building by Miceal Ross. An introductory paper, "Economic Union: the Economic Implications for Ireland," was given by Alan Matthews, whose views have already been published in a slightly different version. Matthews argues that there is a distinction to be drawn between the possible economic benefits to Ireland of a general move towards European union, and the possible costs to Ireland of participation in that union. European union could indeed bring economic benefits, but Irish participation in it would bring industrial and economic costs. Decision-makers might therefore consider weighing the political possibilities of opting for a free ride. However, any decision not to join an evolving European

2. Royal Irish Academy, National Committee for the Study of International Affairs, 7th annual conference, 23 November 1984 (paper by Eamonn Gallagher); Royal Irish Academy, National Committee etc, and the Irish Association for European Studies, Conference on "European Union: The Community at the Crossroads", 12 April 1985. All the above papers are published in *Irish Studies in International Affairs*, Vol 2, No 1, 1985, Royal Irish Academy, Dublin.

Union must be balanced against the risk of thereby putting in jeopardy the benefits of membership of the existing Community. If a free ride should not be possible, a judgement must be made on whether the benefits of the union, including its redistributive policies, would be sufficient to offset any negative effects of membership, or whether it would be possible for Ireland to opt out of particular aspects of the union which it felt would be damaging. Matthews remarks that Ireland might be better to aim at a federal model of integration, rather than at a union model, as the federal model supposes a greater element of transfers from centre to periphery.

The symposium took place on 30 May 1985, one month before the Milan Summit. At that stage it appeared probable that a decision would be taken at the Summit to limit the use of the veto in the Council of Ministers, impelled both by the enlargement to twelve members and the consequently increasing difficulty of reaching a consensus, and by the wish to improve decision-making in general. A decision was also expected on adopting a programme of measures to bring about the free internal market, perhaps involving common standards, a freeing of the provision of services and the eventual elimination of border controls. Some at least of the heads of government realised that the creation of a free internal market would bring not only benefits, but also a social and political need for transitional measures to compensate losers, and that such measures would require additional funds, as would measures to increase co-operation in European research and production. In the event, the Milan Summit decided to move forward both on the EUREKA programme, and, through the intergovernmental conference, on necessary changes to the Treaties. At the time of writing no formal conclusions can be drawn on the outcomes, though a Conference on the establishment of the EUREKA programme was held in Hanover in Autumn 1985, and the Luxembourg Summit of 2-3 December produced a draft package of changes to the Treaties. The package consisted mainly of measures concerned with the internal market, monetary affairs, cohesion, research, the environment, social policy and the powers of Parliament and Commission, as well as a draft treaty on political co-operation. These measures were regarded by Parliament and by some Member States as an inadequate response to the needs outlined above, and by the Danish Parliament as going too far, but have now been agreed.

The papers published here, together with the Matthews paper, address some of the economic questions on which discussion of further European integration should be based. Will European prosperity bring Irish prosperity? Does a free market threaten traditional Irish industry, or aid new Irish industry, or both? How can a small peripheral economy survive and prosper in a monetary union? How much autonomy does an Irish government at present enjoy in monetary and fiscal policy? Are Ireland's interests close to the Community average? Questions such as these are asked by politicians, who expect economists to answer them; economists tend to react by asking further questions, by demanding quantitative data on which to base their assessments. It is one of the positive points of these papers that the economists have been willing to be drawn out on some of these current issues of political economy, even if others remain to be tackled. I believe that the burden of these papers does not suggest any reason for doubting that in the long term it is in Ireland's interest that the Community should be economically and politically strong, and that Ireland should be a full partner in that Community.

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COMPLETING THE MARKET: MACROECONOMIC CONSEQUENCES

JOHN BRADLEY

Human nature does not change. But if men establish rules and institutions that govern relationships between them, and insist that these rules be obeyed, then that fundamentally alters relations between them. This process is the very act of civilisation.

Jean Monnet

1. *Introduction*

We have become used to hearing pessimistic statements of the serious nature of the problems facing the Irish economy. Hence, it is with a sense of familiarity that we read the introductory paragraphs of the Report to the European Council by the *ad hoc* Committee for Institutional Affairs (the Dooge Report henceforth). In them it is claimed that the EEC has failed to realise fully the bright future which was anticipated for it, and that the Member States are in basic disagreement over many economic and political issues. Most seriously, that after ten years of crisis, Europe unlike Japan and the United States, has not achieved a growth rate sufficient to reduce the disturbing figure of over 14 million unemployed.[1]

An Irish perspective on the problems of the EEC was given last year by Professor Kennedy in his Busteed Memorial Lecture (Kennedy, 1985). He commented that it would be reasonable to expect increasing economic interdependence to be accompanied by a strengthening of the international institutions which are designed to co-ordinate national policies which have international spill-over effects. Such institutions, however, remain

1. The Albert and Ball Report to the European Parliament presents a comprehensive analysis of the USA-Japan-Europe comparison (Albert and Ball, 1983). Basevi *et alia*, (1983) present a more theoretical analysis.

weak and largely ineffective and countries continue to ignore the international consequences of many of their policy actions. Indeed, the role of the EEC may *accentuate* the problem since its institutions may facilitate restrictive policies more easily than expansionary policies. The conclusion is that the consequences of a prolonged failure to develop greater international co-operation would be very serious.

The topic of European union, in its many possible forms, is immense and daunting. The Dooge Report and the recent White Paper from the Commission to the European Council are merely the latest in a long line of reports dealing with the evolution of European institutions and policies.[2] Since the members of the Dooge Committee were the direct representatives of the EEC heads of government, we are entitled to believe that their deliberations carry weight and have a high probability of eventual implementation in one form or another. Hence, I shall focus fairly narrowly on the issues raised in the Dooge Report, bearing in mind, of course, its historical background. I further restrict myself to its economic aspects (i.e., mainly Section IIA of the Dooge Report) which set as a priority objective the creation of a homogenous internal economic area. I am in no way antipathetic to the promotion of the common values of civilisation (Section IIB) or to the search for an external identity (Section IIC). I am simply not convinced that co-ordination in matters of culture and defence is a necessary pre-requisite to co-ordiantion of economic policies. The Commission's White Paper, in addition, lays down a fairly precise timetable for the implementation of economic measures in formal documents and laws.

In Section 2 I summarise some of the key economic aspects of the Dooge Report. In Section 3 I examine briefly the important concepts of economic convergence, policy co-ordination and harmonisation, commenting on the obstacles to co-ordination and on the relative paucity of empirical work available which throws light on the international transmission of economic forces. Dooge claims the EMS to be one of the "achievements of the Community during the last decade". The EMS and its precur-

2. Swann, (1984) is a useful and accessible account of progress within the EEC since its foundation. The White Paper, entitled "Completing the Internal Market", was published following the Dooge Report, in June 1985.

sors provide a useful example of a limited form of economic policy co-ordination, and are treated briefly in Section 4. Finally, since Professor Lee has accused economists of lacking a sense of history to temper their preoccupation with the short term (Lee, 1984), I conclude with a brief historical comment on the last time Ireland participated in an economic and political union.

2. *A Homogenous Internal Economic Area*

The Dooge Report sets as a priority the creation of an homogenous internal economic area by bringing about the fully integrated internal market envisaged in the Treaty of Rome. This is seen as an essential (inevitable?) step towards the objective of Economic and Monetary Union (EMU) first described in 1970 by the Werner Committee. The dynamic effects of a large single market are claimed to include "more jobs, more prosperity and faster growth". The means to be used are grouped into four broad categories:

(i) completion of the Treaty;
(ii) creation of a technological community;
(iii) strengthening of the EMS;
(iv) mobilisation of the necessary resources.

Item (ii) seems, within the Committee, to have been relatively uncontroversial and dealt with such matters as European technical standards, public contracts, education and training, etc. Only Greece felt obliged to enter some reservations. Item (iv) appears to show the signs of much internal wrangling which never reached the printed page of the Report. Only the Danish representative was so forthright as to express the view that the budget might be too small! Items (i) and (iii) contain the main policy recommendations of the Dooge committee and are obviously interrelated. Under item (i) three types of "policy" are distinguished:

(a) free movement of labour and capital within the market with co-ordinated economic policies, simplified customs procedures, acceptance of national standards, the strengthening of the EMS, and a broad range of commercial policies;

(b) increased competitiveness by removal of all measures distorting competition, particularly in nationalised industries;

(c) promotion of economic convergence ("promotion of solidarity amongst the Member States aimed at reducing structural imbalances" and "positive action to counter the tendencies to inequality").

Item (i)(c) appears to have been subject to many differing views. For example, the Greek representative wanted more explicit policies. The German and Dutch representatives wished to define "convergence" as "convergence of economic policies". One must assume that they disagreed with a definition of convergence based on living standards, inflation differentials, etc. The Belgians had a similar reservation. The brief text of (i)(c) was penned with sparsenes and subtlety.

Finally, item (iii) expresses satisfaction with the performance of the EMS and advocates movement towards monetary integration by the appropriate economic and monetary policies.

3. *Convergence, Co-ordination, Harmonisation and Interdependence*[3]

In an ideal world one could proceed to examine the consequences of the Dooge economic policy and recommendations of the European Council White Paper, with formal interlinked models of the economies of the EEC Members States. In fact, such formal analysis would have preceded Dooge's and the Commission's work and would have been a major input into it. Unfortunately, no fully satisfactory interlinked models exist, where by satisfactory, one means models which would command a broad assent among economists. In addition, the technical details and problems of such exercises are formidable.[4]

What one can attempt to do is to clarify the meaning of some

3. This section draws from Steinherr, (1984) Cooper, (1985) and Swann, (1984).

4. Helliwell and Padmore, (1985) is a very recent review of the performance and use of linked macroeconometric models of two or more countries. Models which include some, or all, of the EEC countries include Project LINK, Eurolink, Interlink and the European Commission's own model COMET. Helliwell and Padmore conclude that what is needed are clearer explanations of the comparative properties of the component national models as well as a clearer analytical and empirical decomposition of the strength and nature of the links between countries.

basic terms frequently used: convergence, co-ordination, harmonisation and interdependence; develop in general terms the arguments in favour of policy co-ordination in a community of interdependent economies, and explain limits and difficulties of co-ordination. First, *convergence* refers to the attainment of objectives of economic policy while *co-ordination* refers to the choice of mutually consistent target values and the derived selection, magnitude and timing of the instruments of economic policy. In a multi-country economy such as the EEC, *convergence* is usually taken to mean a reduction in the differences between national targets (e.g., per capital income, inflation differentials, unemployment rates, etc.), with the eventual achievement of the most desirable, feasible, target values. Convergence of itself is not desirable. It contains an efficiency objective (a higher level of welfare) and a distributive objective (to close the gap between richer and poorer areas of the EEC). *Harmonisation* is reserved for the setting of rules with the aim of reducing the scope for discretionary decisions and achieving a greater uniformity in economic structure (e.g., tax harmonisation).

Hence, co-ordination is a political process of rendering discretionary national policies more consistent[5] and more likely to achieve policy targets. Co-ordination is "soft" when limited to general or qualitative guidelines. Where co-ordination is understood in the stricter sense of the quantitative commitments, the political and administrative constraints are greater. Macroeconomic policies for open economies differ in important ways from the corresponding policies for closed economies.[6] The openness factor imposes constraints on the effectiveness and conduct of policies and creates interdependence through many channels. International trade links prices in different national economies, a link that is not rigid but one which effectively prevents a country from changing its long-run inflation rate independently of the long-run courses of monetary policy and

5. Steinherr, (1984) illustrates the policy co-ordination problem with both the classical Tinbergen-Meade targets-instruments approache and the game-theoretic approach where the economy can be imagined as representing a dynamic game with several players: the "public", the "monetary authority", and "fiscal authority" and "the European Commission".

6. "The modern open economy is not the one found in most macroeconomic textbooks, an economy that occasionally imports Bordeaux wine, but which produces most of what it consumes at prices determined domestically" (Marston, 1985).

the exchange rate. Changes in aggregate demand in any particular country are transmitted internationally under both fixed and floating exchange rates, constraining the effectiveness of the domestic multipliers. Secondly, international mobility of capital links interest rates on financial assets and limits the power of monetary policy. In the EEC, where barriers to trade and capital flows are less important and where exchange rates are pegged, transmission of changes in competitiveness or in demand conditions is very strong and the need for co-ordination is therefore very great.

Being a small and open economy (SOE) can be an advantage in certain circumstances in that one can more easily enjoy the benefits of a "free ride". However, it is also a disadvantage in that its feedback effects on larger economies can be ignored, and thus large economies can be indifferent to the plight of small economies, while at the same time severely restricting the effectiveness of the SOE's policy actions. Economic policy co-ordination in the EEC must aim at making the choices of the larger more powerful economies acceptable to the smaller economies on the understanding that the smaller economies support the common policies and abstain from "free rides".

Hence, a group of interdependent economies of varying sizes and degrees of openness can choose to operate among four alternatives:

(i) no policy co-ordination;
(ii) policy co-ordination;
(iii) policy harmonisation;
(iv) institutional integration involving the transfer of much discretionary decision making to a central, or Community level.

The Dooge Report and the Commission White Paper operate at various levels between (ii) and (iv) with, however, a strong presumption that full economic union is an inescapable ultimate destination. There may exist optimal levels for policy making, some remaining at a national level with varying degrees of co-ordination, others being transferred to the Community level where co-ordination is important but difficult to achieve.

The reasons for lack of co-ordination lie in the different perspectives and interests among nations, even in settings in which all recognise the potential gain from co-ordination.[7] For example, countries may not agree on policy objectives and may differ on such matters as the balance between fighting inflation and lowering unemployment. Even if their objectives are the same, they may differ in their forecasts, expectations and economic theories, and hence on the relationship between ends and means of policy. They may simply mistrust each other. Finally, public sentiment for preserving national freedom of action still runs sufficiently strong in most countries to make economic policy co-ordination politically difficult. There is often a fundamental confusion between national *autonomy* and national *sovereignty*. Sovereignty is the ability of a nation to act on its own rather than under the coercion of other nations. For example, Ireland could leave the EEC but would, perhaps, have to suffer some unpleasant consequences if she did so. National autonomy, on the other hand, is the ability of a nation to attain its objectives through unilateral action. As we have discussed, this autonomy is heavily constrained in an environment of high economic interdependence. Far from undermining national sovereignty, economic co-operation often represents wise exercise of that sovereignty.

4. *The European Monetary System*

Professor Walsh has pointed to the irony that, for Ireland, the most immediate consequence of the EMS, whose goal was the creation of a wide "zone of monetary stability", was the breakup of the oldest currency union between sovereign states in Europe (Walsh, 1984, p.173). Professor Lee regards the whole issue of Irish entry to the EMS as illustrating "the promise and the pitfalls of the economic imperative" (Lee, 1984). The debate on entry, he says, was dominated by a series of superior technical contribution from the economists. Unfortunately, their virtually unanimous predictions regarding the consequences of entry failed to materialise in the early years of membership.

Long before the Bremen Summit of 1978 where Chancellor Schmidt's initiative led to the setting up of the EMS, the more ambitious goal of Economic and Monetary Union (EMU) had

7. What follows is drawn from Cooper, (1985).

been attempted, i.e., the ultimate state of economic integration in which member countries become merely regions of the union. Basically five ingredients serve to characterise such a union:

(i) free movement of goods and services and a common external tariff — the customs union element;
(ii) free movement of all factors of production (together, (i) and (ii) constitute a Common Market);
(iii) national currencies would have to be fully convertible or would be replaced by a union currency;
(iv) co-ordination of national economic policies;
(v) inter-regional transfers.

In a world where all markets are competitive and all prices perfectly flexible, agents rational and adjustment costs negligible, there would be no need for co-ordination policies or transfers. Each economy would adjust instantaneously to shocks. Policy co-ordination may be regarded as due to market imperfections. Inter-regional transfers can be interpreted as necessary to induce losers to accept a free competitive solution.

Whilst the Treaty of Rome does not call for the creation of an EMU, it does nevertheless contain, in Articles 103 to 109, detailed rules regarding the conduct of macroeconomic policy. In the debate on EMU, two opposing views emerged: those who favoured early action on locking exchange rates on the assumption that the necessary monetary discipline would, therefore, be imposed upon Member States; and those who favoured convergence of economic performance prior to setting immutable parities. The compromise adopted was the system of reduced margins of fluctuation around the central parities known as the snake. The subsequent trials and tribulations of the snake are well known: a period of major world economic instability intervened and sufficient policy co-ordination never became a reality. Chancellor Schmidt's more modest EMS proposal dropped the idea of immutable exchange rates and a common currency and merely aimed at creating a zone of monetary stability in Europe.

The particular problems facing Ireland in the EMS have been well documented and relate mainly to the absence of the UK from the system and the failure to implement supportive domestic economic policies.[8] Of particular interest from our EMS experience are the following:

(i) the very slow adjustment of trade flows to the new exchange rate environment (although McAleese (1984) is less dogmatic on this point than Walsh (1984));[9]

(ii) the prolonged high inflation rate differential between Ireland and other EMS members, but where the close trading relationship with the UK (another high inflation country) removed the pressure to devalue as often as, say, Italy;

(iii) the effort to make Irish incomes policy compatible with our EMS commitment in, for example, the recommendations in the National Planning Board's *Proposal for Plan* that the national maximum wage incease be a weighted index of the pay increases expected in other EMS/EEC countries.

Certainly, it would appear from the Dooge proposal that all Member States participate in the EMS, would attenuate a major source of exchange rate uncertainty for Ireland.

Die ich rief die Geister werd ich
nun nicht los

Goethe

5. *Remembering the Irish Future*[10]

An "Act of Union" must surely rank with "felon setting" as a word which has very negative connotations for Irish people. There is a popular view that Union has been tried before and worked very badly. It is accepted by historians that the Irish economy grew strongly during the 18h century but that growth

8. Walsh, (1984) provides an incisive survey of Ireland's relationship with the EMS.

9. "If we can conclude little else with certainty about the experience of the past three years (1978-1981), we can affirm that a commitment to fixed exchange rates between groupings of countries is not sufficient to result in a restructuring of trade flows", (Walsh, 1984 p.181). However, "It is too early to say exactly how the effects of this change in the pattern of competitiveness will alter the trends in trade flows observed in the 1970s", (McAleese, 1984, p.169).

10. The enigmatic title comes from a television lecture given by Professor Seamus Deane.

turned into industrial decline during the 19th century (Cullen, 1969). Because this decline followed the Act of Union between Great Britain and Ireland, it is often assumed that it was caused by the Union. However, the correlation between the withdrawal of protection in the first quarter of the 19th century and industrial decline is poor. Daniel O'Connell's agitation for the repeal of the Union identified what was described as the "commercial injustices" of the Union as the cause of economic difficulties. There were, however, no injustices in the commercial clauses of the Act of Union. Moreover, Irish tariffs before the Union were already too low to effectively exclude English manufacturers.

The real determinants of Irish economic retardation prior to 1847, although political resentment obscured the issue, may have been outside the legislative and fiscal sphere. Externally, these determinants were the technological and organisational advances of the Industrial Revolution in Great Britain and the radical improvement in transport wrought by the railways; internally it was the growth of population. Technological changes and transport improvements at that time went hand in hand in producing increased competition for small-scale and domestic industry in Ireland and the undermining of industry made the consequences of population growth all the more serious. While there is no universally accepted explanation of how the Irish economy reacted to the economic imperatives of the Union with Great Britain, the 19th century, in addition to providing a rich agenda of historical precedents for modern economic problems, may still provide psychological influences on our attitude to European Union,[11] given that external circumstances today in many ways resemble those facing Ireland in the 19th century.

11. In any public discussion of European Economic Union, one is inclined to overlook the fact that we have recently had a detailed study of the macroeconomic consequences and possible benefits of integrated economic policy, planning and co-ordination in Ireland (New Ireland Forum, 1984). In this case there are, of course, very specific points that dominate the analysis — the savings from cessation of violence and the funding of the external transfers to the North. Nevertheless, it would be interesting to extend further the DKM work to take into account more complex North-South economic interactions if for no other reason but to carry out a debate on economic and policitcal union on grounds which are more directly familiar than the broader, more abstract issue of European union.

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THE ECONOMIC IMPLICATIONS OF TAX HARMONISATION

JOHN D. FITZGERALD

1. *Introduction*

Moves to bring about increased harmonisation of tax systems within the EEC were already underway when Ireland joined the Community in 1973. These efforts bore fruit in the introduction of a common VAT system among all Member States (while still permitting differences in actual VAT rates). In spite of this success, attempts to harmonise the excise tax and corporation tax systems of Member States have consistently failed over the last fifteen years. However, the European Council in Milan in December 1985 expressed the intention of achieving an internal market free of border controls by the end of 1992. This decision follows on the proposals contained in the Spinelli Report for the European Parliament in 1984 and the Dooge Committee Report published in 1985. These moves towards greater harmonisation of tax systems do not originate from a belief in tax harmonisation *per se* but rather from a desire to complete the internal community market by abolishing all economic frontiers. It is believed that such an abolition of border controls and restrictions will result in considerable economic advantages to the Community, advantages which would make any costs involved in the necessary harmonisation of taxes worthwhile (see Albert and Ball, 1983).

If this objective of the abolition of economic frontiers by 1992 is to be achieved it will require considerable changes in the tax systems of Member States over the intervening period, as well as changes in other areas affecting freedom of movement of goods, capital and persons. The programme necessary to achieve this objective is set out in the Commission's White Paper on *Completing the Internal Market* (1985). Whether this objective will be met is a political question not discussed here. However, it should be noted that in the area of tax harmonisation progress will continue in the future to depend on unanimity among all Member States. The Council decision itself and the momentum which it imparts to the Commission will be a major influence on proposals for changes in the tax system in Members of the Community over the next five or seven years. In spite of the potential economic significance for Ireland of these proposals little consideration has been given to them in public debate.

This paper does not attempt to weigh up the overall benefits to Ireland of the programme to complete the internal market. Instead it concentrates on the economic implications of the proposals on tax harmonisation contained in the Commission's White Paper. While absence of a fully articulated plan of the desired final harmonised tax system and the paucity of economic research in this field do not permit definitive conclusions to be reached, it is still possible to provide an assessment of the overall significance for Ireland of current proposals.

The structure of this paper is as follows: Section 2 examines the implications for the Irish tax system of the proposals on tax harmonisation. The economic implications for Ireland of the necessary tax changes are discussed in Section 3 and Section 4 considers the implications for economic policy of the Commission proposals. Conclusions are set out in Section 5.

2. *Implications for the Irish Tax System of Proposals on Harmonisation*

To date the approach to tax harmonisation within the context of either the existing EEC, or within a more tightly knit European Union, has been *ad hoc* in nature. Tax harmonisation has not been seen as an end in itself but is generally seen as a necessary baggage which must be carried on the way to achieving other economic goals. While the absence of a theology of tax harmonisation is to be welcomed the approach runs the danger of ignoring some of the possible economic effects of any proposals. This is due to a concentration on the bargaining process by which any progress towards a harmonised tax system will eventually be achieved. The Commission view appears to be that the eventual harmonised tax system will be as much a weighted average of existing systems as a product of economic analysis. While this may be a realistic appraisal of the decision-making mechanism, the absence of a theoretical framework, such as that underlying the Irish Commission on Taxation reports, may result in a generally unsatisfactory outcome.

The two most important areas which have long been identified by the EEC Commission as necessitating further tax harmonisation are indirect taxation and the taxation of companies. The desire to "complete the internal market" by abolishing all border controls clearly has serious implications for the indirect tax systems of all members. The desire to harmonise company taxation stems from a belief that the existing diversity of tax structures across Member States leads to distortions and results in advantages being conferred on certain companies which some would argue are in some way unfair.

Clearly the abolition of border controls, without tax harmonisation, would result in very considerable trade distortions as individuals evade taxes by buying those goods in neighbouring countries which were subject to a lower tax rate. While certain administrative measures, along the lines proposed by Sijbren (1983) could limit the extent of this evasion to private individuals, rather than to commercial transactions, the scope for distortion of trade patterns would remain large. While it is clear that the abolition of border controls would necessitate the adoption within the European Union of a harmonised, if not an identical tax system, the nature of the harmonised tax system remains to be determined.

In considering the likely structure of a new harmonised indirect tax system an important pointer will clearly be the nature and diversity of the tax systems at present in force in other Member States. Table 1 sets out a comparison of the revenues from different forms of taxation, expressed as a percentage of GDP. The most obvious area of diversity of practice among EEC members in the field of indirect taxes concerns excise taxes. For the EEC as a whole such taxes in 1982 amounted to 4.4 per cent of GDP. In Ireland, on the other hand, they accounted for 10.0 per cent of GDP, the highest figure for any Member State. As a result, while the precise characteristics of a possible new harmonised European tax system would have to be negotiated and are, therefore, unknown, it is highly likely that it would involve a substantial reduction in excise taxes in Ireland. It would, of course, probably also involve significant changes in Italy and Spain, where excise taxes account for a very small percentage of GDP. Revenue from VAT, expressed as a percentage of GDP, shows considerably less diversity across EEC countries than is the case for excise taxes. Thus Ireland is close to the average, where revenue is expressed as a percentage of GDP. (Of course, this does not necessarily mean that the rates of tax are close to the EEC average. Differences in the composition of consumption across countries, in particular, differences engendered by excise taxes, could affect these figures.) Given that extensive work has already been undertaken to harmonise the VAT system this result is not altogether surprising. As a result, any attempt to harmonise VAT rates across countries might involve relatively little change in the Irish VAT system.

The Commission White Paper reports that experience in the US suggests that some difference in tax rates may still be consistent with abolition of border controls. They recommend that up to 5 per cent difference between neighbouring states would be possible without causing major trade distortions. In the light of this experience they recommend that a margin of plus or minus 2½ per cent on either side of a target VAT rate should be permitted. This would substantially reduce the adjustment necessary in the case of the VAT system but would do little to alter the magnitude of the changes required in excise taxes.

Commission proposals also envisage significant action to harmonise company taxation across the Members of the Community as well as strict controls of national state aids to industry. The Commission, in a draft directive, published as long ago as 1975, called for a common tax system with rates ranging from 45 to 55 per cent. Clearly such a proposal, if implemented, would require substantial changes in the Irish tax system.

Corporation tax in Ireland in 1982 accounted for a smaller than average share of GDP. However, when viewed in the context of total tax revenue, the difference is relatively small. The most obvious difference between the Irish corporate tax structure and those of other EEC countries lies in the rate of tax on profits in manufacturing industry. In Ireland the rate of tax is 10 per cent whereas rates in other Member Countries are in the range of 35 per cent to 56 per cent (*Bulletin of the European Communities,* 1980). Harmonisation of tax rates would, therefore,

Table 1: *Comparison of sources of tax revenue in certain EEC countries, revenue as a percentage of GDP*

		Belgium	Denmark	France	Germany	1982 Ireland	Italy	Spain	UK	EEC
Total Taxes on Goods and Services		12.11	16.19	12.97	9.88	18.18	6.57	5.59	11.47	12.00
of which:	Taxes on specific goods and services (excise)	3.60	5.69	3.39	3.34	9.98	1.76	2.45	5.51	4.36
	General taxes on production and sale (VAT)	7.77	9.84	9.25	6.11	7.66	5.61	3.14	5.30	7.17
Total Social Insurance		13.89	1.24	18.87	13.48	5.95	18.84	11.77	8.44	11.88
of which:	Employers' Social Insurance	7.98	0.60	12.57	7.24	3.77	14.82	9.15	3.55	n.a.
	Employees' Social Insurance	4.73	0.65	5.00	6.01	2.13	2.82	2.61	3.00	n.a.
Total Tax on Income, Profits, etc.		19.81	24.51	7.88	12.67	13.67	12.76	6.57	15.03	14.27
of which:	Tax on Corporate Income	2.83	1.14	2.22	1.91	1.87	3.19	1.18	3.79	2.71
	Tax on Personal Income	16.92	23.38	5.62	10.77	11.80	9.71	5.28	11.24	11.53
Total Tax Revenue	1982	46.65	43.97	43.72	37.27	39.57	38.27	25.33	39.60	40.08
						1983				
Total Tax Revenue	1983	n.a.	44.12	44.07	37.19	40.55	n.a.	24.50	38.28	n.a.

Source: Revenue Statistics of OECD Member Countries, 1965-1983.

involve a major change in the Irish tax system.

As well as changes in tax rates, harmonisation of corporation tax systems would also involve a reduction in the very generous Irish provisions on the treatment of investments. While changes in the German and the UK tax systems in the 1970s resulted in an increase in such allowances, causing their tax systems to move closer to our own (FitzGerald, 1983), the tendency in the 1980s, at least in the UK, has been in the opposite direction.

The third area which might necessitate increased harmonisation of the tax systems of members is the provision on the free movement of capital. The introduction of free movement of capital, with no changes in the manner in which the domestic tax administration is integrated with administrations in other countries, could lead to new distortions as people seek to evade Irish tax by moving assets abroad. The growth of non-resident Irish pound bank accounts suggests that such a tendency already exists. Even the harmonisation of legislation on direct taxation across countries would not necessarily prevent such distortions. It is only through co-ordination of tax administrations that loopholes, which allow evasion of taxes through movement of funds out of individual tax jurisdictions, can be closed. (One possible method of reducing the problems in this area would be to introduce a common witholding tax on dividends and interest payments across all Member States.)

Apart from such administrative changes, neither the latest proposals on European Union, nor earlier Commission proposals, would necessitate any further harmonisation of taxes on personal incomes or social security taxes. The fact that these taxes can have at least as important a distortionary impact on companies as capital taxes is totally ignored.

3. *Economic Implications of Tax Changes*

The potential economic effects of tax harmonisation can be considered under a number of different headings. In the case of excise duties the most obvious effect of any harmonisation of tax rates at a level below existing Irish rates (probably substantially below existing Irish rates) would be the loss of revenue incurred. While the replacement of such a tax by alternative taxes might be achieved leaving the level of real personal disposable income unchanged, it would, none the less, pose a serious problem for any Irish government. The choice between raising other taxes and cutting expenditure would obviously depend on the manner in which the revenue gap was closed.

Assuming that there was no change in real personal disposable income, as the revenue loss is offset by other measures, a reduction in excise taxes would substantially affect the relative prices of different commodities. However, even the size of the price change which would result from a reduction in excise taxes would be uncertain. While there is some evidence on tax incidence (Keegan, 1984) which suggests that the bulk of the excise taxes are passed on to the consumer, the possible changes in rates are so large that one would be entering uncharted economic territory. It is quite likely that some of the benefits of lower prices would be taken by producers, distributors and importers. For example, there is some evidence that the net of tax price of cars is lowest in countries with the highest tax rates on cars. This would imply that some of the benefits of a reduction in tax would accrue to foreign producers, some to importers and some to distributors.

The fall in prices, even if it did not fully reflect the fall in taxes, would result in a substantial shifting of consumers' expenditure to consumption of goods which are currently subject to substantial excise taxes, away from the consumption of all other goods. While the model described in Keegan (1984) could possibly provide a basis for examining both questions of incidence and the possible substitution effects of changes in relative prices, experience using such models suggests that, even for marginal price changes, the results may not be very reliable. In cases of very extensive changes in relative prices they would be subject to very large margins of error.

In addition to the effects on the allocation of domestic consumers' expenditure over domestic goods, any substantial change in excise taxes could be expected to affect both tourism exports and imports. If combined with a harmonisation of VAT taxes across the EEC, in particular in Spain, the change would significantly reduce the attractiveness of locations such as Spain to Irish holidaymakers and increase the attractiveness of Ireland to foreign tourists. However, such harmonisation would certainly lead to the growth of non-EEC resorts such as Yugoslavia which would reduce the benefits expected to occur from the reduction in the current, tax-induced, distortions in Irish import and export tourism.

The effect of the changing consumption pattern on the demand for domestic goods and services would need to be examined in the context of an overall model of the Irish economy. The increase in expenditure on cars and petrol, which would occur if excise taxes were reduced, would largely benefit foreign producers of cars and petrol. The diversion of expenditure away from goods with a higher domestic output content would tend to reduce domestic output. However, the results of increased domestic consumption of alcohol would, on the basis of current evidence, tend to benefit the domestic productive sector. Clearly the tourism effects would be beneficial to domestic producers. The overall balance could only be quantified by using a suitable macroeconomic model.

The third report of the Commission on Taxation says that the major argument in favour of excise taxes is one of economic efficiency: they are a substitute for user charges or they attempt to take account of externalities. To the extent that they do, at present, perform this role, there will be a cost to the community at large from their reduction. However, the evidence in this regard is weak. Curtin (1978) showed that revenue from smokers is probably substantially greater than the costs to society of their habit. In the case of alcohol, Walsh's study (1980) suggested that the same was true for Ireland for 1976. However, the effects of a big reduction in excise duties on alcohol could produce much bigger changes in consumption patterns and, therefore, in social costs than might be expected at the margin. As a result, the evidence of previous research is not necessarily a good indicator of the effects of major changes in the structure of excise taxes.

The second important area where European Union might involve changes in the Irish tax system is company taxation. The harmonisation of the tax system itself, in terms of definitions of the tax base, nature of allowances and provisions for imputation need not, of themselves, have major effects on the Irish economy. However, any move to harmonise rates of tax and allowances could, potentially, have very important economic implications for Ireland. If, as the EEC Commission proposed in 1975, rates of corporation tax were harmonised at the 45 to

55 per cent level it would mean a radical change for firms in the manufacturing sector. For those firms which set up in Ireland primarily to obtain the benefit, through transfer pricing, of the low tax rate on profits generated elsewhere, their *raison d'être* would disappear. For other firms or new firms considering setting up in Ireland it would prove a significant discouragement. While no quantitative evidence is available on the likely impact of such a change in tax rates in Ireland, it seems possible that the loss of domestic output would, in the short term, so erode the base for this tax that revenue would fall. It could also erode the bases for other taxes through its effects on employment. Given that the evolution of the structure of the Irish manufacturing sector over the last thirty years has been so intimately related to this tax provision, any sudden change could cause serious disruption. This does not mean that the policy of low tax rates on profits, particularly the profits of foreign multinationals, is necessarily in the long-term interest of Ireland. However, the question would need serious further examination before the long-term effects of harmonisation of tax rates on profits could be estimated.

As well as harmonisation of the rate of corporation tax, the Commission also propose the harmonisation of capital and other allowances which can be offset against taxable profits. This would involve a reduction in the tax allowances granted to investors in Ireland. Taken together with the harmonisation of corporation tax rates it would make Ireland a much less attractive location for investment, especially foreign investment.

However, some harmonisation of the company tax system is not necessarily inimical to Ireland's interests in using the corporation tax system to attract foreign investment. The 1970s saw a progressive and semi-competitive bidding up of capital allowances by many countries such as the UK, Germany and the US. If some order could be imposed which recognised the need of less developed Member States to use the corporation tax system to encourage domestic industrial development, it would save all countries the expense of competition in attracting a limited part of new investment.[1] However, the policy statements of the EEC Commission in the area of company

1. To the extent that Ireland is in competition with non-members of the EEC this would not hold true.

taxation (*Bulletin of the European Communities*, Supplement 1/80) strongly oppose such a development, arguing the need to treat all enterprises equally for corporation tax purposes across all Members of the EEC. (They do not, however, extend this argument to cover the harmonisation of social insurance charges or other similar taxes levied on employers.) The replacement of these tax provisions by the alternative of capital grants or subsidies could also be ruled out under a European Union.

Finally, the harmonisation of tax administration (as opposed to tax systems) in the field of direct taxation could prove beneficial to Ireland. If a common witholding tax were levied on all interest and dividend payments in all EEC countries it could potentially reduce the scope for tax evasion through existing loopholes such as non-resident bank accounts.

4. *Implications for Irish Economic Policy*

There are a number of implications for economic policy of increased tax harmonisation consequent on movement towards European Union. Perhaps the least important restriction placed on domestic freedom of action would be the removal of indirect taxes, especially excise taxes, as an instrument for implementing mid-year adjustments to the stance of fiscal policy. As excise taxes have traditionally borne this role in Ireland in the past, it would necessitate the development of some other policy instrument which could be varied at short notice.

More important than the loss of potential instruments for regulating the economy in the very short term would be the loss of indirect taxation as a potential policy instrument for demand management. In particular, during the course of any adjustment to a harmonised system of indirect taxation, the revenue implications of the change would also serve to reduce the scope for action on direct taxation and expenditure.

However, the scope for using indirect taxation, in particular excise taxes, as an independent instrument is already severely limited. The experience of the last few years highlights the fact that already we cannot depart radically from the structure of indirect taxation in Northern Ireland without serious loss of revenue and distortion of trade. If the UK chooses to enter a European Union involving harmonisation of excise taxes we will be constrained to follow closely their new harmonised excise tax structure. It is only if the UK chooses not to participate that we will have any real freedom of action in this area. If the UK were to choose to continue their present excise tax policy, whereas we harmonised our system of excise taxes with other Community Members, all the costs of trade distortion would fall on the UK and some of the costs of the adjustment in the Republic would be offset by spillover of Northrn Ireland purchasing power into the Republic.

The other area where Irish economic policy would be constrained by tax harmonisation would be the area of corporation tax. For the past thirty years policy in this area has been aimed at increasing domestic economic growth. The restriction on the use of this instrument, without its replacement by some other instrument suitable for influencing domestic supply and growth, could prove serious.

However, even in the case of corporation tax, while we are free to pursue an independent policy, this does not prevent other countries such as the UK, the US and Germany taking evasive or retaliatory action. As a result, the implications of tax harmonisation within a European Union are not clearcut. It is not a straight case of independence outside a European Union and a complete loss of freedom within such a union.

5. *Conclusions*

(i) To a large extent the Commission proposals would fit in with the proposals of the Irish Commission on Taxation and in my view must, therefore, be considered to be desirable. The road dictated by the proposals on tax harmonisation is generally the road we would wish to travel in the longer term. Exceptions are the proposals on company taxation and excise taxes on alcohol.

(ii) The proposed harmonisation of taxes on companies could pose serious problems for Ireland's industrial development in the future. Unless some other mechanism is substituted by the Community to allow low income areas of the Community, such as Ireland, to attract and hold industry, these proposals could prove particularly serious, given the importance of tax incentives in attracting industry to Ireland over the past thirty years. While the Commission on Taxation and other economists may question the validity of this industrial policy in the longer term, there is little doubt that any rapid change in this area could prove especially damaging.

(iii) The economic and social implications of a radical cut in the tax on alcohol need to be considered further.

(iv) In the short to medium term the revenue implications of these changes, in particular the excise tax changes, would be serious. They could result in a re-ordering of priorities so that precedence is given to implementation of reforms in indirect taxes rather than direct taxes. However, in the longer term this issue will probably be less serious and it might be taken account of by some special arrangements allowing adjustment of excise taxes in Ireland to be completed over a slightly longer time scale than that envisaged for other countries.

(v) Finally, it should be noted that if the UK decides to harmonise its indirect tax system with that of the rest of the Community we will, given our common land border, have little choice but to follow them along the same road.

In summary, the long-term costs of a harmonisation of the Irish indirect tax system with that of the rest of the Community are likely to be relatively small and would probably be outweighed by the potential benefits arising from the abolition of economic frontiers which this harmonisation makes possible. The problems in harmonising other forms of taxation may be more serious.

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SUBSIDIARITY, REGIONAL DEVELOPMENT AND NATION BUILDING IN EUROPE

MICEAL ROSS

In the preamble to the Draft Treaty on European Union submitted to the European Parliament and adopted by them on 14 February 1984 we read:

> Determined to increase solidarity between the peoples of Europe, while respecting their historical identity, their dignity and their freedom whithin the framework of freely accepted common institutions;
>
> Convinced of the need to enable local and regional authorities to participate by appropriate methods in the unification of Europe; . . .
>
> Intending to entrust common institutions, in accordance with the principle of subsidiarity, only with those powers required to complete successfully the tasks they may carry out more satisfactorily than the States acting independently;
>
> The High Contracting Parties, Member States of the European Communities, have decided to create a European Union.

This enshrining of the principle of subsidiarity is highly significant. If Europe were organised according to this principle there could be considerable advantages for regional development and citizen participation, as well as a strategy for overcoming the obstacles posed by the entrenched position of the individualistic nation states, and a means by which the conflicting economic philosophies of the market and of socialism could be reconciled.

1. *What, Then, is the Principle of Subsidiarity?*

The principle is easy to enunciate but the practical application of its insights is more complex. Put succinctly this principle holds that responsibilities must be discharged at the most decentralised level in society consistent with their effective performance, and that the individual or group so identified has a right not to have this responsibility usurped by any more centralised level. Equally where satisfactory performance calls for more than the abilities and resources of a particular level that level should transfer the responsibility and right to the first greater social aggregate which can promise an adequate performance. This ceding, however, carries with it both the right of the lower group to be consulted and its duty to co-operate with the higher group. One of the functions of higher groups is to ensure that in the discharge of a duty a lower group acts in a manner consistent with the common good and without infringing the rights of others.

In the concrete situation an individual is normally competent to choose a career, a life style, a spouse, etc., subject to the rights of others but must normally acknowledge the family as having the competence of providing for the emotional and developmental needs of children. The implications of the principle can be traced up the social hierarchy. To a certain extent there are already elements of such an ordering on a geographical basis as when fire services are controlled by municipalities and road repairs by county councils. In the highly centralised nature of Irish society many other functions have been assumed at levels higher than they need to be, thereby weakening or preventing more local participation and control.

Although the idea of empowering the lowest competent level is straightforward any move towards such an ordering of society could stimulate considerable controversy and find itself in conflict with power groups. They are the bureaucrats for whom power is centralised at the top of the pyramid; the professionals who seek to disparage the competence of individuals and groups in favour of their own real or claimed expertise, and those who favour a social engineering approach to dealing with social problems. A major opponent is likely to be those who control the Nation State who have proved as unwilling to restore power to subnational assemblies as to cede power, however important, to beneficial supranational groupings. Decentralisation will, thus, cause tensions but these cannot only be creative in a democracy, they may be urgently needed to revitalise democracy itself in a climate of alienation. Tawney (1966) claims that it is vital to reassert the priority of political over economic values in a society in which industry becomes a form of public service.

The principle of subsidiarity may seem esoteric to those steeped in the political culture of Ireland. Nevertheless it was formulated by the great philosopher, Thomas Aquinas, and lies behind much of the enlightened practices of countries, such as The Netherlands and Sweden. It has inspired the writing of Schumacher and may become ever more important as we move into a post-industrial society less dominated by the division of labour. It has been deemed so valuable as to be enshrined in the preamble of the Draft Treaty of the European Community. Its implications for Irish society cannot be developed here (see Ross, 1984). Instead we shall consider it in relation to the Draft Treaty and the ordering of powers between the Member States and a central co-ordinating group, viewed as a process of European nation building.

2. *Weintraub's Analytical Framework*

One of the shortest yet most rewarding frameworks for the study of nation building was published by Weintraub in 1970. In his approach he adopted a core-periphery analysis which suits our purposes admirably. First, it permits us to treat Europe-building as a series of interactions between the Member States and the central co-ordinating bodies. Second, it indicates that historically nation building has been most successful when core-periphery relationships were inspired by a version of the subsidiarity principle. Third, it notes that the failure to put interactions on a correct basis can negative otherwise laudable attempts of a periphery to improve its position — a truth that must be painfully obvious to all students of the Irish economy today.

To make a crude simplification of Weintraub's vivid and complex canvas we can classify cores by two criteria (a) whether they were powerful and (b) committed to overall development while peripheries can be classified on three bases; first, by their ability to mobilise for their own development, second, by their influence on the centre's policymaking and resource allocation, and by their ability to keep their elites committed locally, and third, by their desire to participate in overall nation building.

Weintraub's typology can be usefully applied to the EEC, both as it has been historically and in the context of the proposed Union. In making this application I shall endeavour to show that each of these factors is itself composed of many dimensions.

3. *The Wealth of the European Community*

Before considering these factors it is instructive to look at the wealth of the Member States with their combined population of 320 million. Even without Iberia the statistics of the EEC are impressive. The work force of 100 million matches that of the US in size. In 1980 savings of $430,000 million exceeded those of the US ($380,000m). Expenditure on R&D was equal to American levels and double the $250m spent by Japan. 400,000m ECU are spent on public procurements. The area engages in 39 per cent of the world trade. It holds one-third of the world's foreign exchange reserves and half its gold reserves. This is power indeed but to a considerable extent its potential is not realised in that it is held by 10 peripheries, now to become 12.

4. *Characteristics of the EEC Core*

In this study I shall refer to the periphery as the Member States and the EEC core as Brussels. The two questions that Weintraub would ask about Brussels are whether it is (1) powerful and (2) committed to Europe-building in conjunction with the Member States. The first concept of power he would refine and seek to answer three subquestions, i.e., is it rich?; has it a mobilisation system?; and can it inform itself adequately on the task of welding together a common European endeavour?

First we need to identify an EEC core in the traditional sense. In so far as we can discover one, it consists of an elected parliament with severely limited powers and a non-elected commission of civil servants. The present core of the Community is dominated by the periphery, i.e., by the intergovernmental system of the Council of Ministers. The essence of the Draft Treaty (and of the Dooge Report) is to transform this into a system of codecision between the European Parliament and Council so that laws require the assent of both and no single government or small group of governments can stand in its way. If this essence is removed the rest of the Draft (or of the Report) is not of much account. In this way it is hoped to grasp the nettle of nationalism at its root and to make progress towards powerful institutions "entirely at the service of the common interest" as Dooge puts it. Such institutions would then constitute the core, even if one of them was the Council of Ministers.

4.(i) *Is the EEC Centre Powerful?*

(a) Is it rich? In other words, does it have autonomous resources and/or can it call on other resources? Brussels has at its disposal the common tariffs, the 1.4 per cent VAT and the resources of the European Investment Bank. These resources are paltry in relation to the resources available to the Member States. However, the latter do not provide the correct yardstick but rather what the resources should be if the principle of subsidiarity was fully applied. As we shall see later there could be a case for limiting strictly the revenues available to Brussels. However, it appears likely that any evaluation would find current levels substantially too low.

(b) Has it a mobilisation system? It has to the extent that it has the resources listed above. It has not to the extent that the common citizens of the Member States do not identify with it. Hence the interest of the EEC in symbols, such as a common passport and regional fund road signs. In his book *Peasants into Frenchmen* Weber (1976) recounted the numerous languages of France: French, Breton, Basque, Catalan, German, Flemish, Italian, Occidental and how it was only in the trenches of the First World War that a common identify of Frenchman was hammered out. The EEC needs to create a similar solidarity before it truly possesses a mobilisation structure. The potential is there and 14 million unemployed should provide the challenge if only the solution can be clearly presented to fire the imagination, as war does. This will be easier to achieve if a sufficient body of political, economic and social opinion identifies clearly a common interest. The researches of Albert and Ball (1983) and the Spinelli proposals are an attempt by the European Parliament to strengthen the core and provide such leadership.

(c) Can it inform itself adequately? The third question on power asks about the extent to which it can draw upon adequate and realistic data for its policies. Currently much of the needed information is monopolised by the Member States and only made available to the extent that they determine to be in their own interests. How much then does Brussels know about the effectiveness of its policy instruments? For example, the regional fund has spent 8,000 million ECUs to date, of which 85 per cent was devoted to reimbursing national governments. Was this a genuine investment increasing the EEC's overall potential or was it merely a case by which each country increased its consumption "with each convinced of its entitlement to a larger share than all the others" (Albert and Ball, 1983, p.18). Brendan Walsh (1984 p.59) has made similar comments on the Social Fund in relation to special employment to unemployed young people.

The basic issue is, given the limited resources of the core, what should it seek to do to overcome recession and underdevelopment. This question is related to the second dimension of a core.

4.(ii) *Is the EEC Centre Committed to the Development of Europe?*

Weintraub refines the concept of commitment by asking a variety of questions:

(a) What is the fundamental guiding image that the core possesses of how development takes place and of its role in this process? There are two polar ideologies held by economists on how developmnt should occur — the market strategy and the socialist experiment. The bureaucratic approach often favours social engineering without necessarily subscribing to socialism. Sociology and political science have other candidates. The principle of subsidiarity would suggest other options.

In its economic inspiration the Treaty of Rome has traditionally tended to favour the market orientation. The very name Common Market indicates its focus on the free movement of goods, services, capital and people. To prevent "distortions" the Treaties give the Commission "exclusive competence" in regulating the internal market, competition policy and international commercial policy. Heeldragging on these dimensions has caused the Draft Treaty to set explicit deadlines for achieving the mobility objectives. The uneven conequences of a liberal market regime are mitigated by the Common Agricultural Policy and the structural policies. Here again a market philosophy dictates what are to be acceptable strategies.

Regional policy has been dominated by the idea that differential infrastructural investments will produce convergence while the social fund emphasises retraining as its contribution to the solution of inequalities. Only recently have these solutions been questioned and a new dimension introduced by reserving some of the resources of the Regional Fund for integrated regional developments. To a large extent the emphasis on liberal trading within the EEC was dictated by the needs of producing a genuine and powerful internal market. The change in the regional fund orientation may augur a rethink of the appropriate contribution of the structural funds towards economic convergence.

What is clearly needed is a mechanism by which the EEC cake is enlarged and at the same time an effective method to be devised by which both lagging regions and areas harmed by the consequence of overall growth can be helped to share in the rising prosperity. Such as a mechanism is provided in embryo by the Draft Treaty in its reference to subsidiarity. It is up to policymakers and their advisers to demonstrate the best form that this should take. Once this is done the executive role of the Commission will need to be strengthened.

One of the problems facing Brussels in its efforts to "complete the internal market" has been the extensive use of non-tariff barriers to trade by countries seeking to compensate for the disappearance of tariffs and quotas. The attempt to combat these devices has led Brussels to define standards for Euro beer, etc., which have had the unfortunate byproduct of enabling opponents to present Brussels as a mindless and faceless bureaucracy and thereby weaken its powers of mobilisation. The new proposals on European standards may overcome this drawback. Equally a clear use of the principle of subsidiarity would be helpful.

(b) To what extent is the core well disposed to Irish development? This is one of numerous supplementary questions about commitment. I have attempted to answer these questions in a paper I wrote several years ago (Ross, 1979). At that time I found an enormous store of goodwill which expressed itself in many practical ways. For example, during the time of the British employment subsidy Irish firms were permitted to receive subsidies while the Commission fought the abuse. On another occasion the EEC used its limited resources to encourage the rationalisation of firms in the clothing and footwear industries. The Western Package is yet another example. Support for Irish development would be all the greater if it could be shown that outlays were well spent.

On the other hand, the CAP is the only instrument that disimburses funds without a local contribution. In some cases the amount of the EEC contribution is small. In others the criteria are based on national averages rather than Community averages and so discriminate against disadvantaged areas. In industrial policy higher percentages are permitted in disadvantaged areas but, as no absolute levels of industrial grants are set, richer areas can often outbid. Schemes for the elimination of inequalities should not favour higher take-up rates among the wealthier areas. The Commission itself is aware of these defects and the new regional policy makes major improvements in funding development. Significantly enough a number of commentators, who were not Irish, have also proposed that regional funds be used exclusively in Ireland, the Mezzogiorno and Greece.

Weintraub also asks if the core's commitment to the periphery can be classified as (a) preserving the status quo; (b) maintenance of the existing order with some developments permitted on given terms; (c) adaptive to change or (d) actually innovative and creative. In this regard the concern of the Commission with science and technology and its efforts to promote co-operation among the Member States must deem it to be innovative.

In summary then the core of the EEC would appear to be weak but committed to Europe's development.

5. *The Characteristics of the Periphery*

Weintraub suggested three dimensions for the periphery:

(i) its ability to mobilise for its own development;

(ii) its influence with the centre and its ability to retain the loyalty of its élites;

(iii) its desire to participate in the give and take of nation building.

5.(i) *To what extent is the periphery capable of mobilising its resources for its own development?*

This crucial question is Weintraub's first about the periphery and one of the keys to the entire Draft Treaty. The key lies in the principle of subsidiarity. It is a curious fact that, despite Ireland's well known name as a Catholic country, the social encyclicals, such as *Quadragesimo Anno*, which drew their inspiration from the principle of subsidiarity have largely been ignored. Instead, and perhaps due to its colonial past, Ireland has preferred the centralising gospel propounded by Sydney and Beatrice Webb. The more human socialism of Cole and Tawney suffered the fate of the encyclicals whose vision they shared. Like the American and French declarations of independence the Webbs' views stressed rights rather than responsibilities. The results are a centralising bureaucracy and an expensive delivery of social goods in which voluntary effort is depreciated as well as a frame of mind which exaggerates the value of the nation State and its ability "to do something". This exaggeration of the State's powers has emasculated local initiative and bred a dependent society willing to leave its destiny to social engineering.

The Spinelli document (EEC, 1984) provides a double challenge to this outlook. It demands that competences be returned to local bodies "convinced of the need to enable local and regional authorities to participate by appropriate methods in the unification of Europe". It would be interesting to see which rouses the hostility of national centralisers more — the idea of giving back powers taken from those lower down or surrendering powers to those higher up.

Equally if a social level is not adequate to discharge a duty it is bound to seek the help of a higher level. "The smaller a country is the greater the external constraint. Overall, the Community's rate of external dependence is of the same order as that of Japan and the United States (10-15% of GNP), while the rate of individual countries such as Germany or France is 25-30%" (Albert and Ball, 1983, p.40). Presumably the external constraint of Ireland is higher. Clearly even the EEC level will be inadequate for some problems. However, a united EEC, with an external dependence of 10 to 15 per cent would be a power in the world arena and able to influence variables towards levels which would be more in tune with its developmental needs. What value would different and lower interest rates have been for European industries, Irish exports and our national debt?

5.(ii) *Is the periphery influential with the centre?*

The nation states that make up the EEC vary enormously in their economic, social, political and symbolic power. In seeking to influence debate there are hidden problems. For example, in a recent talk Weizsächer illustrated succinctly how national perceptions can differ and affect the ability to achieve consensus. Germans concerned with acid rain on their forests sought to have cars fitted with emission controls and were surprised when British and French people interpreted this as an attempt to boost car sales. The Germans proposed to educate the British and French. When the latter retorted that a speed limit in Germany would reduce emissions by 20 per cent the Germans became angry as they were not prepared to give up speedy driving. Frequently Irish stances on underdevelopment or neutrality can be perceived differently by others and often from a sympathetic viewpoint. Effective communication needs to identify such perceptions as they can have important implications for policy applications.

5.(iii) *Does the periphery (nation state) wish to participate in overall European Development?*

Weintraub paraphrased this question asking whether the nation state was primarily concerned with its own interests and needs, or was prepared to share in overall responsibility and give-and-take. This characteristic can be considered along two lines:

(i) What is Ireland's fundamental guiding image of its role in Europe building?

Does it consider itself (a) subject to or (b) above the rules of the game and/or Community guidance and overall goals?

Does Ireland accept active responsibility towards, or is it committed to action for the welfare of all Europe? Does it conceive its responsibility as (a) passive — minimal; (b) tutorial — advisory; (c) regulatory-corrective-redressive or (d) activatory-missionary?

(ii) What price is it willing to pay for participation and what rewards does it expect? Is its orientation (a) self-centred; (b) "philanthropic" or (c) directed towards overall give-and-take?

(i) Its willingness to participate: Sometimes a nation will refuse to pass up problems which it cannot handle itself to a higher level, pleading a vital national interest. If the matter is a genuine national interest as Gaston Thorn (1984) put it, it should be "clearly defined and recognised as such, [so that it] will become the focus of active Community solidarity to assist the country in difficulty. It will no longer serve as an excuse for unbridled exercise of the right of veto" p.19.

However, the contemporary concept of the national interest in fact equates it with the current objectives of the member government concerned. "So long as the governments are able not only to formulate objectives that are in the people's interest but also to carry them out this may be seen, to paraphrase Churchill, as the least bad political system available" (Pinder, 1984). Such autarky applies to fewer and fewer matters and interdependence to more and more. Where objectives can be made operational only if they were formulated and implemented together with other countries, a government's pursuit of "national interest" becomes its attempt to secure as large as possible an element of its own objectives and policies in the common objectives of the countries concerned. In such a wrangle it became hard to identify the common interest of the Community as a whole and so by concentrating on the promotion of several national interests the vast economic challenges that demand a common response failed to find a solution. As Pinder (1984) remarked: " 'National interests' have produced incompetence and irrelevance which would be intolerable in an institution with minor responsibilities. Where the crisis is extremely grave they have acted directly counter to the people's interests".

The emotive term "national" is invoked to maintain the maximum power of national government systems, in effect the vested interests who will not change their political ideas. This seeking of a monopoly is all the more foolish when the nation state has not got the resources to go it alone and there is evidence that Europeans in general would support proposals for a change, such as those proposed in the Draft Treaty. *Eurobarometer* in December 1984 asked Europeans if they were for or against efforts being made to unify Western Europe. In general 77 per cent were in favour, 10 per cent against and 13 per cent didn't know. In the original six the ratio was 82:8:10. Ireland scored

60:13:27. Its level of support was the lowest, apart from Denmark and its level of "don't knows" was the highest — double the average. However, opposition was also lower than in Britain or Greece. The Irish outcome reflects the low level of debate on the issue in Ireland.

6. *States' Rights for the Member States*

Governments need to be persuaded that a curtailment of some of their existing functions offers them more meaningful functions for the future. The Draft Treaty recognises that the various strands of economic and social policy which may be the responsibility of either the Union or the member governments or both are so interdependent that a close co-ordination between the different levels of government is required. In the Draft the member governments operate both nationally and through the Council of Ministers.

What is decided at the core level is spelt out: "Intending to entrust common institutions, in accordance with the principle of subsidiarity, only those powers required to complete successfully the tasks they may carry out more satisfactorily than the States acting independently" — "in particular those whose execution requires action by the Union because their dimension or effects extend beyond national frontiers". This criterion is a two fold one. It means that the States agree to joint decision-making by majority rule and in association with the Parliament in those areas where their individual actions are unlikely to be very productive otherwise. It also means that the Union should not usurp powers which the States can discharge more effectively. At this point many commentators have their own shopping lists. For example, Donges (1984) would limit it to common policies where technical externalities exist or to assure the functioning of a common market.

Experience with the US Federal system indicates that states' rights need to be explicitly safeguarded if creeping centralisation is to be avoided.[1] Weintraub's model favoured a situation of strong cores interacting with strong peripheries. National governments must retain the stuff of healthy political life. Safeguards could be built in in a variety of ways:

1. Much of this analysis is indebted to Pinder (1984).

(a) Union competence could be defined more precisely.

(b) Competences reserved to states could be defined.

(c) Subsidiarity criteria could be defined so that the effectiveness of central action could be weighed against the values of diversity and political vitality.

(d) The instruments of the Union could be defined as limited to a budget not exceeding 5 per cent of GDP, taxes to finance it, a European currency and reserve fund and laws to secure an open internal market;

and (e) the role of the Council in agreeing to legislation might be increased.

The fundamental aim of the Draft Treaty is to persuade enough Member States to accept an effective system of making Union law and policy on central economic issues such as money, interest rates, exchange rates, large-scale research and development and industrial adjustment, external trade and the internal market where common action is vital for recovery. Hopefully the guarantees of state rights will help win over resistance from British, French and other bureaucracies and help to lay to rest the ghost of nationalism that has so tragically haunted Europe in this century. It will be noted that in many of these areas, e.g., money, interest rates, exchange rates, Ireland's exercise of autonomy for decades consisted of maintaining parity with another sovereign state. A clear identification of states' and regional rights according to the principle of subsidiarity function should help overcome some of the fears inhibiting more wholehearted participation.

7. *The assessment of costs and benefits*

A periphery's willingness to share in European give-and-take will depend on the price it is willing to pay and on the rewards it expects in return.

In Ireland perceptions are often limited to the actual flows of funds transferred from Brussels. The £700 million which accrued in 1985, as I said in an earlier (1979) paper, has tended to hyponotise many into overlooking other real benefits that do not involve transfers. The income loss of a marginal change in the milk price is exaggerated in debate and never set in the context of the vastly higher opportunities and potential in concerted European action.

What really matters is that Ireland now belongs to a wider European market with all its interdependencies. The debate over the *juste retour* from the Brussels budget is a debate about *distribution* when the real issue is how to achieve greater European *growth*. In the context of such growth the benefits that would accrue to Ireland far exceed the amounts which are involved in a squabble over budget distributions. This truth has been demonstrated in several studies.[2]

8. *Summary*

In summary then the drive for progress in Europe has been slowed down by the nature of interaction between the European core and its periphery. In Weintraub's terms the Member States can be regarded as mobilised, influential but not participant. The core's weakness does not permit it to demonstrate its commitment to European nation building. The Spinelli draft recognises the fears that many people and politicians have of national identities and initiatives being swamped and proposes a principle of subsidiarity as a safeguard against remote, impersonal decision-making. This paper suggests that the powers that would be shared between the nations and the core are ones which the nations recognise that they cannot exercise effectively on their own. It is the author's belief that such a sharing would improve considerably the interlocking future facing not only Europe but the international economy as a whole.

2. See for example Albert and Ball (1983) or Gonzales (1984).

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