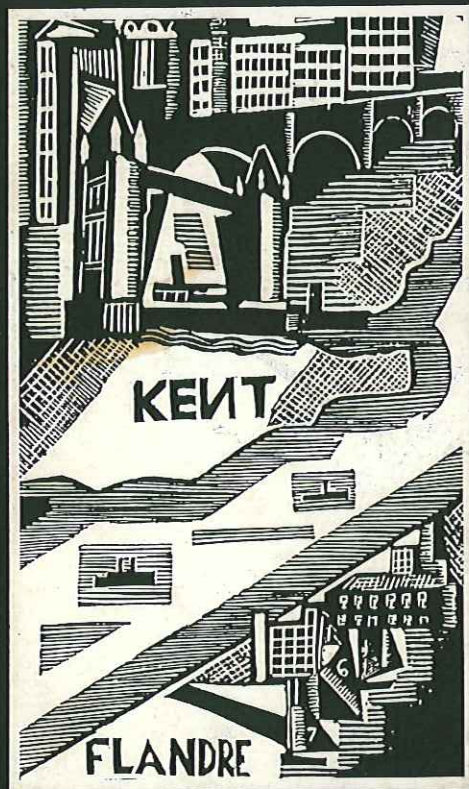


# MAKING IT WORK THE FUTURE OF THE EUROPEAN COMMUNITY



Centre  
for Policy  
Studies

MAKING IT WORK  
THE FUTURE OF  
THE EUROPEAN COMMUNITY

Making It Work: The Future of the European Community was prepared by the European Community Study Group of the Centre of Policy Studies.

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Alan Dashwood  
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## 1 INTRODUCTION

- 1.1 The purpose of this Paper is to try to establish what kind of European Community Britain should be working to bring about in the next 20 years or so. It seeks to provide an answer to two broad questions: what realistically can Britain and her Partners hope to achieve in the longer term through membership of the Community; and what changes or developments are needed in the Community for those hopes to be realised?
- 1.2 We assume (reasonably, we think, in the light of the progress made) that the current negotiations about the distribution of financial burdens and related matters will have a satisfactory outcome. That will enable the Member States to turn, not before time, to unfinished business, in particular the creation of a single internal market, and to exploring new areas of common action. The fact of not having participated in drawing up the original blueprint or in the early building phase of the Community largely explains why Britain has not found adjusting to membership altogether easy. The opportunity to influence the shape of the Community of the next generation must not be missed.
- 1.3 To keep our study within bounds, we have focussed on selected topics which seem to us to be of special importance to Britain and to the Community as a whole. In making recommendations we distinguish between actions to be taken immediately or in the short term (the next 5 years) and actions that are desirable in the long term.
- 1.4 We have been guided throughout by a principle which we call "the principle of common action". It is the principle that the Community should be given those tasks better performed in common than by Member States individually, and the powers needed to carry them out — *no more and no less*.

## 2. THE WAY FORWARD

- 2.1 The European Community must be made to work. This unequivocal view has been reached for three fundamental reasons.
- 2.2 The first draws its strength from Europe's past. No other recent achievement can compare to the definitive resolution of the bitter conflicts between the great nations of Western Europe — conflicts which led to the eclipse of Europe's moral and economic status in the world. The Community has played an indispensable part in this settlement. It has helped to restore confidence in democratic institutions in countries where these were recent and fragile, and has anchored its Members firmly in the Western world. If the ghosts of a belligerent past that is still a vivid memory for many have been laid to rest — as few

would have dared to predict a generation ago — the threat to democracy remains palpable. It is to NATO that Western Europeans owe their ability to deter the Soviet threat. But in resisting propaganda, intimidation and the temptations of appeasement or neutralism, the Community is a powerful force alongside NATO. Despite the quarrels, ingrained habits of economic and political cooperation, besides a growing awareness that the nations of Western Europe stand or fall together, have been great assets to the Western Alliance.

2.1 The second reason why there is no alternative to the Community principally concerns the present. A domestic market of such size and wealth is unprecedented in our history. It renders possible a scale of operations and a division of labour among Member States which, with the completion of the common market, should enable Europeans to compete with the United States, Japan and other dynamic economies.

2.4 The third reason why the Community must succeed derives from the other two, and points towards the future. Though the Community has helped to preserve peace and prosperity in Europe, elsewhere tens of millions have fallen victim to wars, starvation or curable diseases since 1957. Around the political and economic conference-tables of the world, the Community could expect to be heard with the respect due to a free, cultured and benevolent economic giant. Progress towards a common foreign policy, in which all Member States agreed on the ends, if not the means, is still in its infancy; but there is no other framework that will enable Britain to obtain the best possible conditions for trade, and to continue to exert and effective influence on a turbulent world.

2.5 Two contrasting proposals for the future of the Community have recently been put forward.

2.6 Mr Neil Kinnock, echoing Mr Andreas Papandreou, a fellow convert from a policy of withdrawal from the Community, proposes a "new Messina Conference" in order, it seems, to repudiate the consequences of the old one. (For good measure, Mr Kinnock believes we also need a "new Euro Bretton Woods" Conference). One thing only needs to be said about this. No one who takes the idea of a united Europe seriously will contemplate dismantling the Community and starting afresh. For better or worse, the Community has become the focus of the aspiration to unity, and the choice, 26 years on, is to work for change within the system or get out.

2.7 The second proposal deserves more respectful attention. The European Parliament has voted by a large majority for a Draft Treaty on European Union (DTEU), which would take Europe considerably further down the road of supranationalism. The driving force behind the DTEU has been one of the Community's most distinguished figures, the former Commissioner, Mr Altiero Spinelli.

2.8 The DTEU will figure for years to come in discussions about the structure of the Community and its institutions. In our own chapter on

the institutions we refer to some of its proposals. However, we do not believe there is sufficient support at present, either in the electorate or among governments, for a large, formal step of the kind envisaged. Nor would we wish the debate about institutional change to distract attention from urgent practical tasks that, given the will, are capable of being accomplished under existing powers.

2.9 We believe the way forward lies in pragmatic, piecemeal measures, improving, adapting and, where appropriate, extending the European Community we have. The common market is the heart of the system and the first priority must be the removal of the remaining constraints on the movement between the Member States of goods, persons, services and capital. The institutions must be equipped to respond more speedily and effectively to the Community's needs. Where common sense dictates, common action should be taken. But there must be no integration for integration's sake. The aim of freeing the energies and enterprise of Europeans will not be served by moving interventionism to Brussels. The truth holds as much at the Community as the national level that smaller, cheaper government is likely to be better government.

### 3. THE LEGAL ORDER

3.1 The European Community consists of three legally distinct organisations, the ECSC based on the Treaty of Paris of 1951 and the EEC and Euratom based on the Treaties of Rome of 1957. Since 1967 the three Communities have been served by a single set of institutions.

3.2 Viewed from within the Community, the founding Treaties have many of the characteristics of a constitution. They define the scope of the Community's activities and the functions and powers of its institutions. That dispensation cannot be altered without the assent of the national Parliaments.

3.3 There are two main forms of legislation in the Community. Regulations are general law-making acts like statutes. They apply automatically throughout the Community and it is not only unnecessary but impermissible to "naturalise" them by re-enactment. Directives specify an object to be achieved, eg. the adoption of a common standard for a certain product, leaving it to the Member States to make any changes that may be needed in their law or administrative practices.

3.4 Many provisions of Community law are directly effective. This means that the provisions penetrate to the level of the individual, conferring rights and imposing duties which national courts are bound to recognise and enforce. Under the principle of the primacy of Community law, if conflict occurs between a national provision and a Community provision, the latter prevails. So, for example, a female worker can enforce her right to equal pay under Article 119 of the EEC

Treaty against her employer, irrespective of the position in national employment law.

- 3.5 The complaint is sometimes heard in the United Kingdom that the Community is unduly legalistic. That seems to us to be misconceived. Law is the "cement" needed to hold together the political compromises out of which the Community is built. It prevents progress won with great difficulty from being undermined by political pressures in 10, soon to be 12, Member States. We doubt, for instance, whether without a firm framework of law the common market could have survived in any worthwhile form the demands from all sides for import controls and state aids during a decade of recession.

#### 4 MEMBERSHIP

- 4.1 With the expected accession of Spain and Portugal in 1986, the European Community is approaching completion in terms of its share of Western Europe's total population. It is unlikely that over the next twenty years any of the European countries presently outside the Community (with the few exceptions listed below) will apply to join, since they are bound either by treaty or by long tradition to neutrality (Switzerland, Austria, Sweden, Finland) or are ineligible for membership because of their non-democratic regimes (the countries of the Eastern bloc).
- 4.2 Of the Scandinavian countries, this leaves only Norway and Iceland. There are indications that the Norwegians might one day reconsider the decision of their referendum in September 1972 and apply once more to join. This might prompt a re-examination of the question in Sweden, but Iceland is likely to remain content with the free trade arrangements with the Community which she enjoys by virtue of her membership of EFTA.
- 4.3 In the Mediterranean, Turkey, Cyprus and Malta all have Association Agreements with the Community. The Agreement with Turkey, signed in 1963, contains a provision<sup>1</sup> envisaging Turkish membership of the Community at a later stage. Even before the current political difficulties in Turkey, this was not thought likely to arise before the 1990s at the very earliest. The other Association Agreements contain no such provision. There are no indications that a reunited Cyprus might apply for membership, but it is probably that were the opposition Nationalist Party to win the next elections in Malta, an application for membership would be forthcoming.
- 4.4 The working assumption in this Paper is that over the next twenty years the Community will be composed of twelve Member States. Even if Malta were to join, this would make only a negligible difference.

<sup>1</sup>Article 28.

Although, as suggested above, other applications are unlikely, the Community should as a point of principle remain open to further accessions, whilst adhering very firmly to the criteria that the applicant be both European and democratic.

#### 5 THE COMMON MARKET

- 5.1 The case for establishing a European common market is the same today as it was in the 1950s. First, and fundamentally, it involves commitment by the Member States to a market economy in preference to a state-directed economy. A glance round the world of today shows that the countries enjoying relative prosperity and freedom are overwhelmingly those in which competition and the market provide the main measure of economic success. Secondly, it has been clear since the early part of this century that the national markets of European states are insufficient bases for industry. A major reason for the industrial and technological lead of the United States is the size of the domestic market. A genuine internal market in the European Community would bring vast new commercial opportunities. Progress towards this goal is the single most important contribution the Community can make to economic recovery.
- 5.2 Doubts have sometimes been expressed about the capacity of British industries to survive in a common market without tariffs and quotas to protect them. We believe those doubts to be outmoded in the changed economic climate of the past five years. Manufacturers in Britain are now in better shape to meet competition at home and abroad, while our service industries, especially financial services, are the strongest in the Community.
- 5.3 In truth, the protectionist option is simply not available. Eight out of nine Community partners are amongst Britain's top eleven markets. In the ten years following accession British trade within the common market grew almost twice as fast as with the rest of the world. Britain exports nearly 50% more to other Member States of the Community than to the United States, Japan and all the Commonwealth countries combined. We cannot substitute any other market for that of the Community.
- 5.4 The EEC Treaty looked forward to the creation of a common market between the original Member States within a transitional period of 12 years. In such a market goods and services would be supplied irrespective of national frontiers and labour and capital would be free to move wherever they could be employed most profitably. 27 years after the signing of the Treaty, that aim is still far from being realised.
- 5.5 The erection of the Common Customs Tariff and the final abolition of all customs duties and quotas in trade between the Member States took place in mid-1968. However, there remained a great number and

variety of non-tariff barriers to trade. Though many of these have now been abolished, others have sprung up in their place. The cost of complying with formalities at the Community's internal frontiers has been estimated by the Commission at between 5 and 10 per cent of the value of the goods.<sup>1</sup>

5.6 The supply of services, too, continues to be obstructed in many ways. For instance, in a common market a company should be able to cover its risks in all the Member States with a single insurance policy: as things are, it would need ten different policies. Between 3 and 5 per cent is thus added to industry's insurance costs.<sup>2</sup>

5.7 Liberalisation has gone furthest in the case of workers. The Member States have abolished restrictions on the employment of Community nationals except in some branches of the public service and a regime has been established to ensure that migrants do not forfeit their social security entitlements. The right of equal treatment with nationals of the host State extends to workers' families. In this field the Community directly touches the lives of some of its humblest citizens.

5.8 The lifting of restrictions on the movement of capital got off to a good start in 1960 with the adoption of a Directive (amended in 1963) on, among other things, direct investments, personal transactions and portfolio investments. However, the implementation of the Directive has been patchy, and subsequent measures were of limited scope. Discussions about the creation of a European stock exchange seem currently to be stalled, as does an important proposal for a directive on unit trusts. Increased pressure for financial integration is coming from the Commission and the European Parliament. The matter is one on which a British Government which has had the courage to abolish exchange controls is well placed to take a lead.

5.9 The completion of the common market requires a formidable effort of imagination and political will. To secure a prosperous future for the peoples of Europe, that effort must be made.

5.10 Our two following chapters examine more fully the principal remaining barriers to the supply of goods and services within the Community.

## 6 NON-TARIFF BARRIERS TO TRADE

### (i) General

6.1 Non-tariff barriers may result from differences in standards imposed by national legislation or from entrenched administrative attitudes and practices. Or they may be protective measures masquerading in the sheep's clothing of legitimate trade regulation. The temptation in the recession to find ways of protecting domestic industries against imports has been strong and governments have all too frequently succumbed to it.

6.2 Article 100 of the EEC Treaty provides a means of removing non-tariff barriers, through directives for the "approximation" (harmonisation) of national laws, regulations and administrative practices. The directives are enacted by the Council of Ministers on a proposal from the Commission. Unanimity on the Council is required, not under the "Luxembourg Compromise"<sup>1</sup> but by Article 100 itself.

6.3 For many years the rate of adoption of proposed directives was painfully slow. However, in response to a call by the European Council in December 1982, the "Internal" Council of Ministers seems to be making an effort to clear the backlog.

6.4 Harmonisation has a bad name in Britain, partly because very detailed measures, like the one on noisy lawnmowers, are easily caricatured, however sensible they may be, and partly because the Commission has at times exhibited excessive harmonising zeal, lending plausibility to scare stories about "Euro Bread" and "Euro Beer". We recognise that harmonisation is an essential tool in the construction of the Common Market. Each measure must be judged by its effectiveness in furthering that aim.

### (ii) Standards and Testing Procedures

6.5 In every Member State there is legislation laying down health, safety, environmental and other standards that goods must satisfy if they are to be allowed onto the national market. Though standards are typically non-discriminatory, applying equally to domestic products and imports, their existence is liable seriously to impede trade. This is because differences, real or imagined, between the standards applicable in the different Member States may necessitate the production of goods specifically adapted to individual markets; while the organisation of testing on a national basis may lead to duplication and provides scope for covert protectionism. Rapid advances in technology mean

1. Report by the Commission to the Council, 24 February 1983, COM (83) 80 final, p.8.

2. Liliana Archibald, "European insurance-time is running out", *Lloyd's Log*, April 1984, p.3.

<sup>1</sup>As to this, see the chapter on *The Community's Institutions* below.

that new standards are constantly needed, so the problem is getting worse all the time.

- 6.6 British policy has been to focus on the creation of international standards within the International Organisation for Standardisation (ISO) and, for electrical goods, the International Electro-Technical Commission (IEC). However, agreement may not always be possible at this international level but only at European level, within the European Committee for Standardisation (CEN) and the European Committee for Electro-Technical Standardisation (CENELEC), bodies which include the EFTA countries as well as the Members of the European Community. The general strategy of the Commission's harmonisation programme has been to replace national standards with commonly agreed European standards drawn up by CEN and CENELEC.
- 6.7 The loose harmonisation mechanism used in the "low voltage Directive" (which applies to electrical equipment, mostly domestic, with voltages of 50 to 1,000v AC and 75 to 1,500v DC) was a real step forward. A soundly made consumer electrical product, safe in normal use, may be sold anywhere in the Community. Compliance with CENELEC standards or, in their absence, with national ones, is to be taken as *prima facie* evidence of compliance with the Directive.
- 6.8 Testing and certification cause serious problems. Though most of the directives harmonising technical standards lay down procedures for common rules on testing and Community Type Approval certificates, national testing procedures are in general not mutually recognised. Moreover, the testing body is often dominated by local manufacturers who may impose unreasonable delays on foreign goods.
- 6.9 In March 1983 the Council adopted a Directive which, among other things, obliges governments to communicate to the Commission the texts of draft regulations introducing new technical standards. This should put the Commission in a better position to forestall national moves that may restrict trade and, if necessary, to come forward with an appropriate proposal for harmonisation.
- 6.10 In April 1984 agreement was reached on a common set of technical standards for products from non-member countries and on an instrument to enable the Community to react to unfair trading practices by such countries. For practical and political reasons a connection had been made between the control of imports from outside the Community and the adoption of a set of fifteen technical directives, which the agreement has unblocked. The goods concerned include domestic appliances, electro-medical technology and construction equipment; the way is now clear for many other categories to be incorporated.
- 6.11 There is no call for harmonisation where the application of a national standard to imports is prohibited by the Treaty itself. The famous *Cassis de Dijon* case is authority for the principle that goods lawfully manufactured and marketed within the Community cannot be

kept off the market of a Member State merely because they do not comply with the particular standards applicable in that State. Everything depends on whether the application of the national standards is genuinely necessary to satisfy what the Court of Justice calls "mandatory requirements". If imported goods in fact satisfy those requirements, it is immaterial that they may do so in a different way from that envisaged by the law of the State of importation.

- 6.12 The catalogue of mandatory requirements is determined by Community law, as interpreted by the Court of Justice, not by the Member States unilaterally, and it remains open. Examples are the protection of public health, fairness of commercial transactions, protection of the consumer and improvement of working conditions.
- 6.13 The *Cassis de Dijon* case concerned a German law making the marketing of fruit liqueurs conditional upon their having a minimum alcohol content of 25%. A German court was asked by an importer of Cassis from France whether the drink, which has a minimum alcohol content of between 15 and 20 percent, could lawfully be excluded from the German market. The Court of Justice, to which the question was referred, held in effect that the Cassis must be allowed in, since the application of the German standard to it could not be shown to be necessary to satisfy any mandatory requirement. If it was desirable for consumers to know the alcohol content of drinks, this could be achieved by a labelling requirement.
- 6.14 Inadmissible barriers are dealt with by putting pressure on the Member State responsible and, if necessary, by bringing an action against it in the Court of Justice. The Commission has been energetic in prosecuting abuses, though with mixed success: it secured the removal of the British ban on UHT milk, but not of the French ban on British lamb. Another problem is the slowness of the procedure, which can take a year or more. During that time domestic producers will be enjoying illicit protection.
- 6.15 It is also possible for an individual trader like the importer of Cassis to challenge national authorities by legal action in the courts of the Member State concerned, to justify the application of a standard. Such a litigant must, however, be willing to face the cost and delay of legal proceedings which may well include a reference to the Court of Justice. He must also find the courage to "take on" authorities who may be in a position to make his life difficult in other ways; and there must be an appropriate national remedy available, as well as the national court willing to entertain his claim. Those conditions are not uniformly met in all the Member States.
- 6.16 For the short to medium term our recommendations are these:
- (a) The programme for the harmonisation of standards should be completed, subject to the need for updating, within 5 years. Strong pressure to meet this deadline should be put upon the Council by



the European Parliament and the Commission; and they should enlist the support of industry, the principal victim of the Council's dilatoriness. If Ministers are politically committed to making a reality of the common market, technical objections raised by their experts can be overcome. Matters could be expedited by adopting the most acceptable national standard, wherever possible, instead of searching for the ideal European one.

- (b) National and European standards bodies should be given the resources they need to play their part. Every effort should be made to develop close working relationships between the various bodies.
- (c) The Government of each Member State should be required to designate in each of the other Member States one or more laboratories to test goods; and should undertake to recognise the findings of such laboratories. The standards applied would be common ones, where these were available; otherwise the standards of the importing State.
- (d) The procedure for securing the removal of illegal barriers should be strengthened. Any Member State that refuses, as did France during the "Lamb War", to comply with a ruling by the Court of Justice should be liable to a penalty in the form of forfeiture of payments due to it from the Community.<sup>1</sup> In addition, a procedure should be introduced to enable the Commission or a Member State to obtain an injunction from the Court of Justice to deal, in days rather than months or years, with flagrant abuses of standards.
- (e) Traders should be made aware of their right of direct challenge under the *Cassis de Dijon* principle and be encouraged to exploit it to the full. Remedies for the enforcement of Community rights in national courts should be harmonised, to ensure that traders enjoy equality before the law.

6.17 Those steps would represent an enormous advance towards the goal of a unified market. However, we believe that some degree of misuse of standards for protectionist purposes is inevitable, as long as responsibility for testing and certification remains with national administrations. In the long term the only fully satisfactory solution will be for those functions to be handed over to a Community inspectorate responsible to the Commission.

### (iii) *Customs Formalities and Procedures*

6.18 Any traveller in the Community will be aware that customs posts and customs officers remain very much part of the scene. Now that tariffs

<sup>1</sup>There is a precedent for the imposition of financial sanctions on defaulting Member States in the coal and steel sectors: see Article 88 ECSC.

in trade between the Member States have gone, customs procedures mainly concern internal taxes, notably VAT and such matters as the origin of goods and compliance with standards. Delays and resulting costs are prodigious.

6.19 The problem is partly one of customs administrations failing adequately to meet the admittedly heavy demands the Community system makes on them. Though unacceptable in the disruption it caused, the French lorry drivers' strike in February 1984 was the product of real grievances over unnecessary delays at the Franco-Italian border. The onus is on governments to make clear to their own officials the priority they attach to furthering the common market. Reform to coordinate the opening hours of customs posts is welcomed. Maximum advantage should be taken of applications in the customs field of new information technology.

6.20 We welcome the progress made in reaching agreement on a single customs document for trade within the Community. This will replace some 70 forms at present in use among the 10 Member States. Different national demands for matters to be included have resulted in a document of some fifty clauses which will run to 6 or 7 pages. This is a clear improvement but the proposed document is still far too long and complicated.

6.21 Also welcome is the new Regulation that allows people like doctors, journalists and plumbers to carry the tools of their trade across frontiers for temporary use in another Member State without having to lodge a guarantee. This is one of the points at which the free movement of goods and of services intersect.

6.22 In the long term we favour the same solution here as with the testing and certification of goods — denationalisation. To ensure that customs rules are applied uniformly at the frontiers of the Community and that the checks that may remain necessary where goods move from one Member State to another do not harm the unity of the market, a Community-controlled customs service should replace the separate national customs services.

### (iv) *Transport Barriers*

6.23 The main barrier to the road transport of goods within the Community is to be found in the annually negotiated quotas established by bilateral agreements between governments and, to a lesser extent, under Community arrangements. While some agreements are liberal, others provide for a limited number of permits on each side, which are allocated by national Ministries of Transport. Countries in the Community that operate restrictions are France, the Federal Republic of Germany and Italy. Quotas can lead to distortions. Thus the British/German agreement is more restrictive than the Dutch/German agree-

ment; so, when all the available permits for direct shipments between the United Kingdom and Germany have been used up, goods have had to be sent via the Netherlands. As for Community quotas, these remain extremely limited, due in part to resistance from the French, German and Italian governments. Their resistance stems less from protectionism than from considerations such as Germany's environmental policy of steering traffic towards the railways.

- 6.24 The system of bilateral quotas for road transport is incompatible with the establishment of a common market. We recommend that it should be ended as soon as possible. The EEC Treaty envisages a common transport policy. The emergence of such a policy would be welcome if it spelled the end of transport quotas but it must not be used to bring in new restrictions; on the contrary, exceptions on environmental or other grounds to the free movement of goods must be subjected to rigorous scrutiny.
- 6.25 The strength of the rural lobby against the movement of heavy lorries through small villages and along minor roads is recognised. But this is best dealt with, not by restricting cross-border movement or the use of efficient and safe lorries, but by confining large commercial vehicles to motorways, trunk and major roads.

#### (v) VAT

- 6.26 Under the so-called "destination" principle VAT on goods sold for export is owed to the country of importation. The exporter collects no VAT from the buyer and, moreover, receives a credit for any tax paid on previous transactions in relation to the goods.
- 6.27 The majority of Member States levy on imports at the time when they cross the frontier. This involves valuation of the goods by customs officers and is one of the main causes of frontier delays. It is rightly perceived by the Commission as an unjustified barrier to trade and the Draft Fourteenth Directive on VAT was put forward to secure its removal.
- 6.28 The Draft Directive adopts the Postponed Accounting System (PAS) which has hitherto applied in the United Kingdom but which in his Budget Statement of 13 March 1984 the Chancellor announced the intention of abandoning. Essentially, PAS allows the tax due on importation to be postponed and accounted for in the course of the importer's normal VAT returns. This has given importers in effect a rolling interest-free loan at the taxpayer's expense amounting, if the period of postponement is taken as 11 weeks, to £1.6 billion (1983 estimate). Since VAT is charged on domestic products as part of the purchase price, the result has been to encourage customers to look abroad for supplies — an extraordinary case of reverse discrimination.
- 6.29 A middle course has been adopted by the Benelux countries and

Ireland, where payment may be deferred until 30 days after customs clearance. This Deferred Payment System (DPS) is the one it is proposed to introduce in the United Kingdom. It has the advantage of removing payment of tax from the frontier, while preserving reasonable neutrality between imports and domestic products.

- 6.30 We strongly recommend the withdrawal of the Draft Fourteenth Directive in its present form and its replacement by a proposal incorporating DPS.
- 6.31 Wide differences between rates of VAT in the Member States reflect differences in national attitudes, notably about the balance between direct and indirect taxes. They seem likely to continue, although some degree of harmonisation, bringing rates within "bands", may be possible and desirable.
- 6.32 In the long term it may be possible, with the help of computers, to avoid the break in collection which occurs on exportation, through some sort of complex clearing system between VAT authorities.

#### (vi) Public Procurement

- 6.33 Public procurement, including military and space equipment, represents about 15% of the Community's GNP.<sup>1</sup>
- 6.34 In a well functioning common market, public contracts would be awarded on commercial criteria without regard to a firm's nationality.
- 6.35 Machinery for the liberalisation of the market in public procurement is found in Directives on public works contracts and public supply contracts. Where contracts exceed a certain value, they must be advertised in the Official Journal of the European Communities and there is a procedure for complaints by firms which feel they have been unfairly treated. This machinery is complemented at the international level by a 1981 GATT agreement.
- 6.36 In practice the effect has been limited. The area is one of acute national sensitivity and incompatible technical standards have added to the problem. Department of Trade statistics show that in the United Kingdom few public contracts go to other Member States: in 1979 and 1980 Germany was by far the leading supplier with 7% of central government contracts, no other Member State receiving more than about 3%. As for British experience abroad, the CBI has stated that a local subsidiary to act as a presence in the market is almost essential to obtain European government business.
- 6.37 We can see no alternative to a policy of slow attrition. Governments should encourage their nationals to apply for public contracts in other Member States and, if dissatisfied, to complain vigorously. The Com-

<sup>1</sup>Report by the Commission to the Council, 24th February 1983 COM (83) 80 final, p.22.

mission must remain vigilant and prosecute every detectable case of discrimination. In the case of projects co-financed by the Community, strict observance of the Directives should be insisted upon.

## 7 SERVICES

### 7.1 General

The EEC Treaty gives suppliers of services in the Community the right to export their services either by establishing an office or branch in another Member State or by acquiring a company there (freedom of establishment)<sup>1</sup> or by way of cross-frontier operations from their home base (freedom to provide services)<sup>2</sup>.

7.2 The right in each case is essentially one of equal treatment with nationals of the State to which the service is exported. The authorities of that State may, accordingly, insist that, for instance, a certain professional qualification be held or certain financial safeguards be provided, so long as the requirements apply also to nationals. Clearly, such requirements may hinder establishment and the provision of services, calling for harmonisation and/or mutual recognition of qualifications and controls.

7.3 Much has been done towards realising freedom to provide services for the medical and para-medical professions. Directives are in force for the mutual recognition and, where necessary, harmonisation of the qualifications of doctors, dentists, nurses, midwives and veterinary surgeons. Other professions still await the legislator's attention — the proposed directive on architects has been pending for almost 16 years. In the case of lawyers there is a directive on freedom to provide services but not yet on establishment. We recommend immediate action to complete the legislative programme on the professions, but with this caveat. A considerable degree of *de facto* liberalisation has been achieved through tolerance of practitioners lacking local qualifications but recognised as competent in their particular line of work, e.g. specialists in international law. There is a danger that, by imposing formalities and safeguards, directives designed to facilitate the exportation of professional services may in the end make the position more restrictive. That is an outcome to be avoided.

7.4 Of much greater commercial significance are the various safeguards and other restrictions that apply to providers of financial services.

7.5 We welcome the progress made in the banking sector. A Directive of 1977 on the authorisation of banks and other credit institutions

sought to reduce the discretionary powers of the supervisory bodies in certain Member States by establishing objective criteria, notably adequate capitalisation and the control of the business by at least two managers. The scope that existed for disguised discrimination is well illustrated by the criterion of economic need, available in Italy as grounds for refusing authorisation. Seven years were allowed — over-generously in our view — for this to be phased out. Another important step was the Directive of 1983 on the supervision on a consolidated basis of banks that operate transnationally. Work of highly technical character remains to be done, eg. on the Community definition of "own funds", but we believe that harmonisation could, and should, be completed within 5 years. The British objective of keeping the banking system as open as possible has been pursued so far with success. It must not be lost sight of.

7.6 Establishment and the provision of services continue to be impeded by national measures that purport to safeguard the public against financial risks, but are in fact grossly excessive. Thus mortgage institutions are effectively barred from operating outside their own countries, so that house buyers are denied a choice between methods of raising finance. Another example is the failure of German legislation on insurance to draw a sufficiently clear distinction between business risks and consumer risks. It should be the normal presumption that businessmen are capable of looking after themselves and they should be free to look for the best bargain. A common market in insurance services is of special interest to the United Kingdom and we return to the subject below.

7.7 More boldness should have been shown by the Commission and by suppliers of services in challenging obstacles caused by unnecessary safeguards. The lesson of the *Van Wesemael*<sup>1</sup> case in 1979 seems to have sunk in only recently. That case concerned legislation in Belgium making it an offence to hire an entertainer through a foreign theatrical agency, except where a licensed Belgian agency acted as an intermediary. Belgian impresarios were resorting to theatrical agencies in France for the very good reason that the commission charged was 10 percent, as compared with 25 percent in Belgium, and two prosecutions were brought. The matter was referred to the Court of Justice, which held that a requirement of the kind in question must be "objectively justified". There could be no such justification "when the person providing a service is established in another Member State and in that State holds a licence issued under conditions comparable to those required by the State in which the service is provided and his activities are subject in the first State to proper supervision . . ."

7.8 The existence of public services monopolies inhibits the development of a common market in a number of services. Thus, whereas in

<sup>1</sup>See Arts. 52 to 58 EEC. Producers and suppliers of goods also enjoy freedom of establishment.

<sup>2</sup>See Arts. 59 to 66 EEC.

<sup>1</sup>Joined cases 110 and 111/78, (1979) ECR 35.

Britain air couriers are allowed to operate through statutory derogation from the postal monopoly, they enjoy no such concession elsewhere in the Community. Article 90(2) of the EEC Treaty creates an exception in favour of "undertakings entrusted with the operation of services of general economic interest": they are subject to the rules of the Treaty only in so far as the application of those rules does not obstruct the performance of their tasks. Public service monopolies are, therefore, open to challenge on the ground that their performance would not necessarily be impaired by exposure to competition from the private sector. British experience with the Post Office and British Telecom tends to confirm this. There is also a proviso to the exception in Article 90(2) — "The development of trade must not be affected to such an extent as would be contrary to the interests of the Community." The exclusion of some services, such as air couriers, is clearly capable of having that kind of adverse effect.

7.9 We call upon the Commission to investigate public service monopolies in the Member States to discover:

- (a) whether they genuinely need exclusive rights to enable them to perform their tasks; and
- (b) what effect such rights have on the development of trade.

Legal action should be brought in any case that is not clearly covered by Article 90(2).

7.10 A case demanding urgent action is that of air transport. High fares add to businessmen's costs and impose a handicap on those established at a distance from the centre of the Community. The level of fares is the result of restrictive measures to protect national airlines. Those measures may well be open to challenge under the rules on competition. The aim in the long term should be to unify the Community's airspace. All flights between airports in the Member States should count as domestic flights and licences to operate routes should be granted to Community carriers irrespective of their nationality.

#### 7.11 Insurance

There are four Directives of considerable importance for our purposes:

- (a) The Reinsurance Directive provides for the abolition of restrictions on freedom of establishment and freedom to provide services in respect of reinsurance and retrocession (re-reinsurance). A common market in reinsurance<sup>1</sup> has been substantially achieved.
- (b) The Co-Insurance Directive was the first step towards coordinating national laws on the provision of cross-frontier direct non-life insurance services. It applies to certain risks situated within the Community that are covered by a single contract, at an overall premium and for the same period, by two or more insurance

<sup>1</sup>In reinsurance the insurer or underwriter secures himself against the risk he has undertaken.

undertakings, at least two of them established within the Community. In implementing the Directive, France and Denmark limited its application to transactions where the lead insurer is established in the Member State in which the risk is situated. That illegal restriction is being challenged by the Commission. Only the United Kingdom and the Netherlands appear to be giving effect to the spirit of the Directive.

- (c) The Non-Life Establishment Directive harmonises the requirements to be fulfilled by any insurer setting up a head office, branch or agency within the Community to carry on direct non-life business. It provides for prior authorisation and a system of concurrent supervision. It is the supervisory authority in the State where the insurer is established that has responsibility for verifying the solvency of the insurer with respect to its entire world-wide business. As a result of the Directive, the Community's insurers have to fulfil broadly similar financial requirements.
- (d) The Life Establishment Directive similarly harmonises the requirements for setting up life insurance businesses.
- (e) The Insurance Brokers Directive coordinates the standards of training, experience and good repute required of persons wishing to carry on business in the EEC as insurance brokers.

7.12 Thanks to these Directives, it is now by and large possible for an insurer or broker from one of the Member States to become established in another Member State. But insurers are far from being free to underwrite risks in Member States where they are not established or authorised under the local law.

7.13 The following are examples of restrictions on that right:

- (a) Some Member States, notably the Federal Republic of Germany, prohibit foreign insurers from underwriting risks within their jurisdiction unless they are *established* there, under the direct control of the relevant supervisory authority; similarly brokers are prohibited from placing risks with insurers outside the jurisdiction. This amounts to the abrogation of the right, granted by the Treaty, to provide cross-frontier insurance services without establishment. A German broker, Mr Schleicher, has recently been prosecuted and fined by the German authorities for placing risks with London insurers not established in Germany. The Commission is taking the Federal Republic to the Court of Justice.
- (b) Some Member States prevent insurers from underwriting risks within their jurisdiction unless they have been *authorised* under the local law; similarly, brokers may be prohibited from placing risks with insurers not authorised in the same State. Authorisation procedures for insurance activities are invariably time-consuming and expensive and place severe administrative burdens on applicants. This is especially the case with highly competitive under-

writing, where the terms of policies and premiums are rapidly negotiated to meet the needs of individual customers.

(c) The supervisory authorities in some Member States, notably France and the Federal Republic of Germany, exercise strict controls over the terms and conditions of policies offered by insurers within their jurisdictions. Even if foreign insurers obtained authorisation to operate within the relevant State, their ability to compete both in terms of the scope of the policy offered and in terms of the premium may be severely restricted. The Commission is currently investigating practices in the German fire insurance market to see whether any agreements restrict competition in breach of Article 85 of the Treaty.

(d) Some Member States have thwarted foreign insurers who have succeeded in obtaining business in their countries by refusing exchange control authorisation to enable premiums to be paid.

(e) Among more detailed restrictions, we draw attention to the rule that not more than 20 percent of French registered ships (hulls) may be insured outside France, and then only with official consent.

7.14 Freedom to provide cross-frontier insurance services would benefit insurers in the United Kingdom and in the Community as a whole. Competitive insurers would be able to expand on a Community scale without incurring the costs of establishment in each Member State in which they wished to operate; and this would increase their ability to operate in the rest of the world.

7.15 Delay in creating a common market for insurance may well lead to the loss of business for the Community's insurers. In the important area of industrial, fire and accident insurance, for example, multinationals with plants in several Member States require block insurance to cover all their risks throughout the Community. Unless the Community insurance market is freed, multinationals will increasingly look for alternative means of cover, for example by placing business with offshore insurers or themselves setting up insurance subsidiaries ("captive companies") in tax havens.

7.16 Manufacturers and other commercial undertakings that buy insurance within the Community would also benefit from the availability of a wider range of insurance cover and more competitive premiums. The effect on production costs would be significant. Liberalisation of transport insurance (particularly marine and aviation insurance) would promote international trade, both between Member States and with countries outside the Community.

7.17 Consumers would also benefit. They would have cheaper goods, as reductions in production costs were passed on. As policy-holders, they would benefit from a greater choice of insurance cover and lower premiums.

7.18 The completion of the common market in insurance is, we believe,

an aim for the short term. Restrictions resulting from justified safeguards will have to be removed by harmonisation. However, there is considerable scope under the law as it stands for action against the more protectionist Member States. Unnecessary constraints should be directly challenged: by the insurers or brokers affected, in the appropriate national court; and by the Commission, or by any Member State concerned to open up the market, in the Court of Justice.

## 8 COMPETITION

### (i) General

8.1 To ensure that the common market genuinely operates as a market, a Community competition policy is indispensable.

8.2 Interference with competition may come either from the behaviour of business undertakings, whether private or public, or from the granting of government aid to industry. We deal with the first kind of interference in this chapter and with the second kind in our chapter on Industrial Policy.

### (ii) Machinery

8.3 The basic rules on anticompetitive behaviour by undertakings are found in Articles 85 and 86 of the EEC Treaty. Article 85(1) prohibits agreements or concerted practices restricting or distorting competition within the common market, subject to the possibility of obtaining exemption for agreements or practices which fulfil certain conditions laid down by Article 85(3) (the "gateway"); and Article 86 prohibits the abuse by one or more undertakings of a dominant position (monopoly) within the common market or a substantial part of it. In both cases the prohibition applies only where the effect on competition is liable to be felt in more than one Member State.

8.4 Under Regulation No 17 the Commission has power, in particular: to start proceedings on the basis of complaints by alleged victims of anticompetitive behaviour or on its own initiative; to request information from undertakings and conduct investigations on their premises; to grant exemption from the prohibition in Article 85(1) where a restrictive agreement or practice fulfils the conditions in Article 85(3); if satisfied that an infringement of Article 85 or Article 86 is occurring, to order its cessation; and to impose fines (up to 10 per cent of turnover during the previous year) on undertakings guilty of infringements.

8.5 Decisions by the Commission in competition matters can be challenged by bringing an action in the Court of Justice.

8.6 In the course of competition proceedings the Commission is required to maintain close contact with the competent authorities of the

Member States, such as the Office of Fair Trading in the United Kingdom. There is an Advisory Committee on Restrictive Practices and Monopolies, composed of national officials, which must be consulted before any formal decision is taken.

(iii) *Mergers*

8.7 A gap in the existing machinery is the inadequacy of the power to control mergers.<sup>1</sup> Article 86 EEC was designed to prevent already dominant undertakings from abusing their economic power. A merger which extends an existing dominant position may amount to an abuse within the meaning of the Article.<sup>2</sup> However, since the lowest market share of an undertaking found by the Court of Justice to be dominant is 40-45 per cent,<sup>3</sup> a high, and possibly harmful, degree of concentrations will already have occurred before the Article can be invoked.

<sup>1</sup> Except in the coal and steel sectors; see Article 66 ECSC.

<sup>2</sup> Case 6/72, *Europemballage and Continental Can Company v Commission* (1973) ECR 215.

<sup>3</sup> Case 27/76, *United Brands Company v Commission* (1978) ECR 207.

8.8 The meeting of Heads of State or of Government in Paris in October 1972 called for "the formulation of measures that ensure that mergers affecting firms established in the Community are in harmony with the economic and social aims of the Community . . .".<sup>1</sup> That call has yet to be answered. The Commission submitted a draft regulation on merger control to the Council in July 1973 but, more than a decade later, no legislation has been forthcoming.

8.9 We recommend the establishment of an EEC system of merger control based on a flexible concept of the public interest of the Community. This can be done by a regulation of the Council. It will be necessary to strike a balance between the need for an effective vetting procedure, including prior notification of important mergers, and the need for matters to be speedily resolved, so that a deal which may be unobjectionable, or positively beneficial, will not "go off the boil".

(iv) A "Board of Assessors"

8.10 In competition proceedings the Commission combines the functions of prosecutor and judge. This has been a major factor contributing to the hostility felt by many in business towards the Community's competition policy.

<sup>1</sup> See the Communiqué, point 7.

8.11 The Commission, to its credit, has taken the criticism seriously. In 1982 it appointed a Hearing Officer whose task is to ensure that the parties are given a fair hearing and that full account is taken of all relevant matters at the decision-making stage. The Hearing Office has direct access to the Member of the Commission holding the competition portfolio.

8.12 That reform, in our view, does not go far enough to restore the confidence of the business community. Doubts are bound to persist about the fairness of the quasi-penal process in which all the major steps, from the initiation of the investigation to the drafting of the decision, are taken by officials of the Directorate General for competition (DG IV).

8.13 We believe that a new, independent body should be set up to advise the Commission on the application of the rules of competition in individual cases. For the sake of argument we call it the "Board of Assessors". The Board would consider the "prosecution" case prepared by DG IV and the written and oral submissions of the parties concerned and would adopt a reasoned opinion, which would be published in the Official Journal of the European Communities. The power of decision would remain with the Commission but, if it chose not to follow the Board's opinion, its reasons would have to be spelt out carefully. Otherwise, a party challenging the decision in proceedings before the Court of Justice would be able to cite the Commission's failure to meet the points made by the Board.

8.14 A new Directorate should be established within DG IV to service the Board of Assessors. The members of the Board should be the people who have achieved distinction in relevant fields, e.g. economists, industrialists, trade unionists. They should be appointed by the Council on a part-time basis, like the members of the Monopolies and Mergers Commission in the United Kingdom, so that they may remain active in their careers, and should be appropriately remunerated. The Board should be large enough to be organised into a number of panels, each with its list of cases.

8.15 The establishment of the Board of Assessors could be achieved by amending Regulation No. 17.

(v) *The "gateway" in Article 85(3)*

8.16 Article 85(3) creates a "gateway" through which restrictive agreements or practices may escape prohibition if their overall effect appears to be economically beneficial. Whether the provision can be relied on to save an agreement which is otherwise liable to be caught by Article 85(1) is a question to which businessmen require a prompt and clear answer.

- 8.17 Exemption may be granted by regulations relating to classes of agreements, and this has been done for certain exclusive dealing and specialisation agreements. However, in the great majority of cases the only way of obtaining exemption is by notifying the agreement in question to the Commission. The vetting of individual notifications places a burden on DG IV which has resulted in long delays, often of years, before a decision is taken. Of some 4,000 cases pending before the Commission at the end of 1983, some 3,500 were notifications. Clearly a problem on such a scale could not be solved merely by the increase in manpower we advocate below.
- 8.18 Uncertainty is heightened by the fact that, with the exception of an increasingly insignificant class of agreements covered by transitional provisions, notification to the Commission does not confer even temporary validity on an agreement eventually refused exemption. So parties to a notified agreement may find it impossible to enforce, until the Commission make up its mind one way or the other.
- 8.19 The recent practice of issuing so-called "comfort" letters, where the Commission proposes to close its file on an agreement without taking a formal decision, has shortened delays, but is less than satisfactory because such letters do not bind the Commission itself or the national courts.
- 8.20 We believe that all agreements should be deemed to be valid throughout the period of notification, regardless of whether or not exemption is granted in the end. This would increase legal certainty and provide a positive incentive to notify.
- 8.21 In addition, there should be a time limit after which notified agreements automatically receive exemption. The Commission should be given, say, 90 days in which to form a provisional view as to the eligibility of an agreement for exemption. At the end of that period the agreement would be automatically exempted from the prohibition in Article 85(1) for, say, 3 years, unless the Commission had notified the parties that it was seriously doubtful whether the Conditions in Article 85(3) were met. In the latter case, an eventual decision refusing exemption should not affect the validity of the agreement retrospectively, unless the notification were found to be tainted by fraud or negligence.<sup>1</sup>
- 8.22 These changes in the law on the application of Article 85(3) could be effected by amending Regulation No. 17.

<sup>1</sup>Our solution is along the lines of that recommended by the House of Lords' Select Committee on the European Communities in its Report of 23 February 1982, *Competition Practice in the European Economic Community*. There is a precedent in Regulation 1017/68, which applies the rules on competition to rail and road transport.

(vi) Policy

- 8.23 The main thrust of the Commission's attack on restrictive practices and monopolies has been against those with a tendency to divide the market. Import and export bans, designed to maintain differences in the price of a product on different national markets, are regarded as particularly offensive and attract the highest fines. That seems right. All the effort that has gone, and must still go, into removing state-imposed barriers to trade would be futile if undertakings were allowed to arrange protection for themselves against competition from other Member States.
- 8.24 In our chapter on Industrial Policy we stress the importance of transnational collaboration in research and development to ensure a future for the Community, alongside the United States and Japan, in the exploitation of high technology. Due allowance will have to be made in the competition policy for any mergers or joint ventures between major European manufacturers that may prove necessary.
- 8.25 DG IV's ability to operate effectively is impaired by a severe lack of manpower. Directorate B, which is responsible for enforcement, has a total staff of 30 A-Grade officials, 8 B-Grade officials and 14 secretaries. That is several times smaller than equivalent national agencies, e.g. the Office of Fair Trading in the United Kingdom. We recommend a substantial increase in Directorate B to enable it to handle more cases and to make it more of a match for the giant multinationals it often finds itself opposing. The increase should be at the expense of other Directorates-General whose tasks are not so essential to a well functioning common market.
- 8.26 The main failure of the Community's competition policy has been the lack of courage shown by the Commission in applying the rules to public undertakings. The EEC Treaty does not interfere with the right of the governments of the Member States to determine the size and composition of their public sectors but this tolerance of diversity is only possible within a common market if public and private undertakings are treated equally in law and in practice. Directive 80/723 on the transparency of financial relations between Member States and public undertakings should make the task of enforcement easier, if only the Commission will grasp this nettle firmly.

## 9 MONETARY POLICY AND THE EUROPEAN MONETARY SYSTEM

### (i) The European Monetary System (EMS)

- 9.1 The objective of the EMS is to create "a zone of monetary stability in Europe" through an exchange rate mechanism and a new currency

unit (the ECU). It both encourages and relies upon greater coordination and convergence of members' monetary and economic policies

9.2 Established in March 1979, the EMS succeeded the looser currency arrangement known as the "Snake", which had been advocated by the 1969 Werner Report. The report called for a complete monetary union with irrevocably fixed exchange rates and free currency convertibility within the EEC by 1980. This target was abandoned in 1974.

9.3 With the exception of Greece, all EEC countries are members of the EMS, although the United Kingdom is not a full member in the sense that it does not participate in the exchange rate mechanism.

#### (ii) *The Exchange Rate Mechanism (ERM)*

9.4 The ERM involves a "parity grid" of cross rates. Individual currencies are allowed a margin of fluctuation of 2.25% (6% for the Italian lire) from the central rate in ECUs (see below). The "divergence indicator" is a warning system designed to limit the tendency of any single currency to depart from the system as a whole. The indicator is triggered for a given currency when it passes a fixed threshold of 75% of its maximum divergence from the system.

9.5 The system has tolerated fairly frequent, and sometimes large, changes of central parities. Though there have been 7 realignments to date, members of the ERM are generally agreed that the mechanism has helped to stabilise exchange rates.

9.6 If two currencies approach their bilateral intervention limits, there is no obligation for both Central Banks to intervene to prevent the limit being breached (failing, of course, realignment of central parties). The Central Bank of the stronger currency buys the weaker one, while the weaker currency sells the stronger one.

#### (iii) *The Intervention Mechanism*

9.7 If Central Banks need to borrow each other's currencies, there are certain credit arrangements:

- (a) A very short-term financing facility (VSTF) through which Central Banks afford credit up to 45 days (extendable) to each other in their own currencies;
- (b) A mechanism of short-term monetary support (STMS) up to 3 months (renewable), funded by quota subscriptions;
- (c) Medium-term financial assistance (MTFA) providing balance of payments financing in certain circumstances, on a conditional basis, with funding by country up to certain ceilings.

The Credit mechanisms under (b) and (c) are engaged by the European Monetary Cooperation Fund (EMCF).

9.8 Britain is party to these arrangements and to all consultations and discussions relating to the functioning of the EMS.

9.9 Apart from drawing on the VSTF, neither STMS nor MTFA have been used. This is probably because the support facilities for unconditional borrowing on international markets available to Member States have made resort to them unnecessary. Since the EMS became operative, on the Community loan mechanism (which is in any case outside the system) has been called upon.

#### (iv) *The European Currency Unit (ECU)*

9.10 The ECU is a composite monetary unit consisting of a "basket" of fixed amounts of each Commission currency (including Sterling but not the Greek Drachma), with different weightings fixed initially according to each country's relative GNP and importance in international trade.

9.11 The present weight of a particular currency is the ratio between the number of units of that currency in the basket and the value of that basket in that particular currency, which will gain or lose weight according to whether it appreciates or depreciates against the other currencies in the basket.

9.12 In the framework of the EMS the ECU is used:

- (a) as a denominator for the exchange rate mechanism, ie. the central parity around which the actual value of each currency fluctuates;
- (b) as a reference unit for the operation of the divergence indicator from the central parity;
- (c) as a denominator in the intervention and credit mechanisms in the framework of the VSTF and of the EMCF;
- (d) as a reserve asset, the Central Banks depositing with the EMCF 20% of their gold holdings and 20% of their dollar reserves in return for ECUs.

9.13 From 1 January 1980 onwards, the ECU became officially the only unit that could be used by the Community where the need for a non-national currency was felt. Community bodies use the ECU, not only as a unit of account, but also increasingly as a means of denomination and even of settlement. For instance, the European Development Fund denominates its aid in ECUs. However, in the case of the CAP expenditure is denominated in ECUs, and these in turn are converted into national currencies on the basis of specific rates known as "green" rates.

9.14 Private use of the ECU in the European financial markets has expanded rapidly in contrast with its official use, which has remained fairly static. An increasing volume of international bond issues is denominated in ECUs both by Community and non-Community borrowers. There have also been a number of Euro Credits denominated in



ECUs, with the active participation of British banks; as well as deposit accounts, certificates of deposit, savings books and insurance policies. The use of ECUs for travellers' cheques is imminent.

9.15 An important use of the ECU is trade between Member States. It is available as an alternative to the Dollar if the exporter or importer is unwilling to use the other's currency.

9.16 The ECU's status as a currency has been legally recognised in France, Belgium and Luxembourg, and accepted *de facto* by the Netherlands. The only major exception is the Federal Republic of Germany. Since the ECU is a basket of currencies, and therefore can only be described as an "index", trade in ECUs is illegal in Germany.

#### (v) *The Second Phase of the EMS*

9.17 The resolution of the European Council at its meeting in Bremen in December 1978, which established the EMS, provided for the consolidation of procedures into a final system, "the institutional phase", within two years. This was to include the formation of a European Monetary Fund and full utilisation of the ECU as a reserve asset and means of settlement.

9.18 A review was carried out in September 1979 but no changes were made, as it was found that the system was working satisfactorily. During 1980 it became clear that a two-year transition was not feasible, but the Council resolved to continue the development of the EMS and to make the transition to the institutional stage "at the appropriate time". It was agreed that priority should be given to the achievement of greater convergence of economic and monetary policies and performance.

#### (vi) *Development of the EMS and the Extension of the role of the ECU*

9.19 Europe should build up its own monetary organisation rather than passively complain about the effects of fluctuations in the Dollar. The central role of the Dollar in the Community should be wound down and an active effort made to establish a common attitude towards the Dollar as well as towards the Yen. A "zone of probability" of the ECU/Dollar and of the ECU/Yen exchange rates should be targeted. The ECU should be freely convertible into other currencies, instead of its present limited convertibility.

9.20 The EMS should be opened up to Central Banks of certain third world countries by authorising them to acquire and hold ECUs. This would help to diversify world reserves, thereby increasing monetary stability. It would also help, in times of overall external Community deficit, as during the oil crisis, to finance this deficit, following the example of the United States. To this end the ECU's negotiability

worldwide should be extended and the EMCF should be able to issue ECUs to third countries. The ECU would then become a practical alternative to the US Dollar.

9.21 The ECU should be regarded as a currency like any other. Its increasingly diversified use, together with the liberalisation of capital movements, would be a major advance in the construction of the common market.

9.22 The development of the EMS will not be a real success without greater institutional coordination and the convergence of economic and monetary policies. Four years' experience have shown that monetary policies, though strongly influenced by the system's requirements, have not converged sufficiently.

9.23 Some suggested concrete measures comprise:

- (a) phasing out restrictions on capital movements denominated in ECUs, at least within the Community, the absence of a genuine European capital market having hitherto been partly compensated for by the rapid development of the Euromarket with the US Dollar as its main vehicle;
- (b) continuous discussion between Member States of intermediate monetary policies;
- (c) systematic monitoring of balance of payments and external indebtedness.

9.24 The EMS will not achieve its full potential until the exchange rates of all Community currencies are on an equal footing. The entry of Sterling into the ERM "at the appropriate time" and "when conditions are right" means that the EMS would no longer hinge as it does today principally on the DM. Sterling is particularly important as a trade currency and as a vehicle for capital movements. Answering to different international forces from the DM, it would cause the EMS to become bipolar, and hence to register more accurately the various tendencies influencing the Community. In the meantime, increasing private use of the ECU should be encouraged even without Britain having joined the ERM.

#### (vii) *The Creation of a European Monetary Fund (EMF)*

9.25 The EMF would be an expansion of the present EMCF. It would be concerned with all aspects of monetary policy, including exchange rates, external financing, and internal monetary developments. National member currencies would be left to existing Central Banks. Currency realignments would have to be commonly agreed by members, but the Fund would also be involved in the decision-making process.

9.26 The Fund would of course need an important initial endowment of reserves. All existing support arrangements would be transferred to the EMF. The EMF would be entrusted with coordinating policy towards

external currency areas and organising interventions, whether acting itself or leaving it to the Central Banks. It would (but according to agreed procedures and criteria) be able to act quickly, without hampering consultations. The aim of the EMF would be to help create within Europe a zone of monetary stability.

(viii) *British Participation in the Exchange Rate Mechanism: The Medium-Term Horizon*

9.27 The arguments for and against British participation in the ERM are grouped under four headings;

- (a) the monetary and "competition" arguments;
- (b) the financial and oil arguments;
- (c) relations with the US Dollar;
- (d) the political arguments.

9.28 The aims of joining the ERM are both to iron out erratic and harmful fluctuations and to prevent "opportunistic" adjustments. Within the EMS, if a currency wants support, it gets it, and with it added credibility, which avoids unnecessary crises. If it needs a fundamental adjustment, nothing prevents it.

9.29 The argument that exchange rate fluctuations do not interfere with investment decisions, though popular in certain industrial circles, is not particularly convincing if one looks at the record in the last year of British manufacturers in this field. Long-term investment decisions, particularly in export-orientated sectors, are harder to take in a context of uncertainty, though the course of future exchange rates is not the sole element. Parity changes of an appropriate size in the direction indicated by fundamental variables should cause less concern for business than significant and reversible misalignments of a floating currency.

9.30 As long as the Government holds the view that there should be no firm target for Sterling's exchange rate, and that it prefers to control domestic money supply, joining the ERM will be difficult. For a trial period, a wider band such as 6% could be envisaged which would leave plenty of room to manoeuvre short of readjustment, which would always remain feasible. As we have lived for some years in a world of unstable floating rates sometimes free, sometimes managed, surely any move towards convergence and stability must be compatible with leaving the exchange rate to the market.

9.31 It is often said that Sterling is not a suitable currency for the EMS because, unlike the other currencies, it is so widely traded internationally and hence more subject to the influence of large and unpredictable capital flows. This is certainly less true today than it used to be.

9.32 The argument that the Pound has become a "petromoney" and therefore reacts to different stimuli than other components of the ECU was undoubtedly true during the two oil crises of 1973 and 1979. But

now that the oil prices have somewhat stabilised, this argument has lost some weight. Nevertheless, the peculiar characteristics of the oil factor, especially its dependence on sudden events in the Middle East, do at present give Sterling a character not shared by the other EMS currencies.

9.33 Another argument is that participation in the ERM would increase Sterling's volatility against the Dollar or Yen. Surely the contrary must be true. Sterling's participation in a forward-looking and open EMS bloc would increase its standing in the US and Japan. Only by participating in the ERM will the British authorities be in a position to influence both the EDM rate and the Dollar policy of the EMS as a whole.

9.34 There is a fundamental choice to be made between standing alone or acting in concert in such a sensitive area of national sovereignty. Backed by the prestige of the City of London, Britain would, as a participant in the ERM, be better placed to exert formal influence and win others over to free market policies. The United Kingdom should not repeat the mistake of staying outside while such an important new venture is created.

9.35 A commitment to the ERM would also mean greater reliance on "external discipline" to restrain inflation and budgetary deficits. Civil Servants in all Member States are naturally often averse to being subjected to such a discipline. It must be imposed from above. In the meantime, the policies of Member States are converging more than three or four years ago. This is an indication that progress in building a European Monetary Union could be resumed, though there must be no return to exchange controls to impose close economic convergence.

9.35 The problem today is not so much where we want to get to, but how to reach it. In twenty years from now the many difficulties we encounter today should have been overcome and there will be a European monetary identity, with national currencies and the ECU existing side by side, each having different specialised roles and functions. There will be a European Monetary Fund, or Authority or possibly a Central Bank (London would be the obvious location), overseeing adjustments within the Community and playing a leading role in relations with external areas. The Community has now at its disposal one-third of the world's foreign exchange reserves and half of its gold reserves. It should use the resources at its disposal to create a major monetary zone, with a stabilising effect on world trade and capital movements. Britain, with a revitalised industry and a flourishing City, should play the leading part in designing the new financial community for which she is naturally destined.

## 10 INDUSTRIAL POLICY

### (i) General

10.1 The EEC Treaty contains no Title on industrial policy. The framers of the Treaty evidently believed the creation of an open and competitive market and some co-ordination of national economic policies would be enough to ensure that industry in the Community would flourish. The recession, competition from the USA, Japan and the newly industrialised countries and the need to develop activities to counterbalance the CAP were among the factors that brought a change of approach. Scattered elements of a more interventionist policy appeared during the 1970s and these have been given focus in the 1980s by the Commission's call for a strategy to improve the international competitiveness of industry in the Community. At the same time, in exercising its supervisory powers over the granting of aid by the Member States, the Commission has taken a somewhat benign view of national initiatives aimed at industrial "restructuring".

10.2 We recommend the following as general principles to be observed, together with the principle of common action, in formulating industrial policy for the Community:

- (1) The common market must remain the centrepiece of the Commission's policy for industry, in both manufacturing and services. Interventions, whether at the level of the Community or of the Member States, that are liable to set back the completion of the common market are unacceptable.
- (2) Measures taken by the Community must not contradict national policies designed to bring inflation and public expenditure under control.
- (3) Short term solutions, however politically attractive, must be eschewed where they threaten recovery in the medium term. This applies, above all, to the "creation" of jobs in an already overblown public sector.

### (ii) Ways and means

10.3 The Community has at its disposal a variety of financial instruments that can be used for the purposes of an industrial policy. Worth noticing here are:

#### (a) The European Investment Bank (EIB)

The EIB was established as an institution in its own right under an express provision of the EEC Treaty. It raises funds on the capital markets and relends the money, after covering running costs, on terms more favourable than its clients would be able to obtain as ordinary commercial borrowers. In practice, loans by the EIB are mainly for infrastructure and energy products.

#### (b) The New Community Instrument (NIC or "Ortoli Facility")

The NIC was created in 1978 specifically as an instrument to promote economic recovery. Its funds are raised on the capital markets and administered by the EIB. The low interest rates are subsidised from the Community's Budget.

#### (c) The European Social Fund (ESF)

The ESF is the Community's main instrument for alleviating the social distress caused by unemployment. Assistance is available for such purposes as retraining redundant workers, training for new technologies, youth opportunity training and schemes to extend the employment of women and the handicapped. There are separate funds available under the ECSC Treaty to assist redundant miners and steelworkers.

#### (d) The European Regional Development Fund (ERDF)

The ERDF was established in 1975. Most of its resources are divided between the Member States in fixed quotas. Governments reimburse themselves out of the ERDF for expenditure on regional projects.

10.4 Industrial policy is not only about the disbursement of funds. Thus further harmonisation of company law and company taxation is needed to facilitate the development of truly European industries. A measure that we recommend for urgent consideration is the adoption of a European company form. That would make it possible for companies based in different Member States to collaborate without having to face the political and psychological pressure of choosing a nationality for their joint venture. A draft statute for a Societas Europea (SE) was put forward by the Commission in 1970 and a revised version in 1975. It has been held up mainly by ideological wrangles about employee participation, to which a compromise solution could, and should, be found.

### (iii) Products with a high technological content

10.5 In their Report, "Towards European Economic Recovery in the 1980s", which was commissioned by the European Parliament, Mr Michael Albert and Professor James Ball sound the alarm over the performance of the Community's industry in the development of products based on the application of new technologies, especially information technology. They conclude that "For the first time since the 18th century the major formative initiatives of an industrial revolution are not originating in Europe. Europe is 'missing out' on the third industrial revolution." Figures quoted by the Commission tend to confirm this. For instance, 8 out of 10 personal computers sold in Europe are imported from the USA and 9 out of 10 video recorders from Japan, while Europe-based manufacturers of integrated circuits supply only

30 per cent of their home market and represent only 13 per cent of world production, half of that share coming from subsidiaries in the United States.

10.6 Such a degree of technological dependence in a field like electronics which increasingly influences almost every aspect of industrial life seems thoroughly undesirable. Albert and Ball make it clear that the Community's weakness in research and development stems not so much from lack of investment as from the relatively ineffective deployment of funds. They tell us, for example, that, whereas between 1977 and 1981 the sum earmarked for the development of micro processors in the Community was double that in Japan, the Japanese share of the world market has now gone up to 40 per cent, as compared with a European share of less than 10 per cent.

10.7 We therefore support intervention by the Community to encourage research and development in the industrial application of new technologies. The measures taken should favour transnational collaboration, to avoid wasteful duplication of effort. The adoption by the Council on 28th February 1984 of the work programme for ESPRII was an important first step, which we welcome.

(iv) *Small businesses*

10.8 Measures to encourage small businesses in the Community are important for various reasons: to broaden the social base of private enterprise; to enhance the capability of industry to adapt and innovate; to provide opportunities of employment. Financial help should be in the form of "soft" loans, as opposed to grants, which should be made through private institutions applying commercial criteria.

(v) *Steel*

10.9 Over-capacity remains the chief problem of the Community's steel industry. It is estimated by the Commission to be of the order of 56 to 58 million tonnes for crude steel, and 48 to 50 million tonnes for finished products, up to the end of 1984.

10.10 Under the ECSC Treaty the institutions of the Community have unusually wide powers of management in the steel sector, including a power to impose production quotas. Such quotas, based on traditional market shares, penalise efficient producers. We should not wish to see a similar power introduced in respect of other industries in difficulties, eg shipbuilding or textiles.

10.11 For the future we believe that policy for steel should be based on these principles:

- (a) Because of steel's fundamental role in manufacturing generally and in defence, the Community must maintain a viable steel industry.

- (b) Restructuring must aim to ensure, in the words of Article 2 ECSC, "the most rational distribution of production at the highest possible level of productivity". The most obsolete and uneconomic plants must be phased out first.
- (c) Because steel works are found in areas of high unemployment, special efforts must be made to help redundant workers.

(vi) *State aid*

10.12 Aid granted by governments to their industries is liable to distort competition in the common market, since it gives the aided products an unearned advantage on both home and export markets. The EEC Treaty deals with this problem by conferring on the Commission wide discretionary power to ban national aids which it considers incompatible with the common market.

10.13 In exercising its power the Commission seeks to ensure that aid is used not merely to keep ailing industries alive but to finance the often painful measures needed to restore economic health. This is the right approach, though we would wish it to be pursued less indulgently, especially in the case of aid to public undertakings.

10.14 The Commission should also insist on strict compliance with the Member States' obligation to notify it in advance of plans to introduce new aids. Where a scheme is introduced without notification and clearance, the Commission should order the government concerned to recover any sums that have been disbursed.

10.15 Illegally aided imports may represent a threat to an industry in the Member State of importation which would otherwise be perfectly viable. The government of that State could retaliate by introducing its own scheme of aid, but that would make no economic sense. On the other hand, any attempt to exclude the aided products would be liable to fall foul of the principle of internal free trade. We believe that, to ensure compliance with the obligation to notify new aids and with any ban by the Commission, a derogation from that principle is necessary. The Commission should be empowered to authorise the imposition, in appropriate cases, of countervailing duties in respect of illegally aided products imported from other Member States.

## 11. ENERGY POLICY

*General*

11.1 The need for a coordinated approach to the supply of energy was thrown into relief by the "oil shocks" of the 1970s. The European Community has developed its own energy policy in the wider framework of the International Energy Agency.

- 11.2 While special Treaties exist for coal and nuclear fuel, it was necessary to fall back on the general powers of the EEC Treaty as a basis for an overall energy policy. However, no one seriously questions the Community's legal right to pursue such a policy.
- 11.3 The main burden of energy policy inevitably falls on the Member States. The Community has neither the financial nor the administrative resources for intervention on a larger scale. Its role must be that of overseer, monitoring developments in the energy markets, coordinating national policies so as to avoid conflict, pinpointing difficulties and devising appropriate solutions. It can also help with funding research and development where the risks involved are high enough to deter private investment. In the international field the collective power of the Community may be put to effective use. Finally, the Community may legitimately concern itself with developing an environmental policy consonant with its energy policy.

(ii) *Current policy*

- 11.4 The current energy policy has three main strands.

(a) *Diversification of supply*

- 11.5 A central aim is to change habits of consumption from imported oil to alternative fuels. Coal is the Community's most abundant indigenous source of energy. It is Community policy to render the factors contributing to all coal prices as visible as possible, so that the costs of local and imported coal may be fairly compared. The rationalisation of the coal industry inevitably follows from this policy; but though the social costs fall overwhelmingly on the Member States, the Community does contribute from its own resources to retraining programmes. The combustion of solid fuels can cause pollution, and when this affects more than one country — as may be case with "acid rain" — the Community is well placed to debate the problem and to suggest solutions to disputes arising from it.
- 11.6 Indigenous supplies of oil and natural gas are also available as substitutes for imports. The Community has a limited function in assisting exploration and exploitation of reserves such as those in the North Sea. It also seeks to increase storage and reserve production capacity; to expand the transport grid for fuel; and to intensify research into substitutes for natural gas.
- 11.7 In 1957 when the EURATOM Treaty was signed it was believed that nuclear power was about to become an important source of energy. The apparently inexhaustible glut of cheap oil during the 1960s reduced the need for nuclear energy and the incentive for investment and research. Now nuclear energy is once again viewed as having great

significance, particularly as an input fuel into electricity generation. The Community's role is essentially one of ensuring the ready availability of technology and addressing some of the "public interest" obstacles (eg health and safety, the environment) that hinder development.

- 11.8 New and renewable sources (in the form primarily of hydroelectric power and geothermal power) play only a modest part in satisfying the Community's energy needs, at present about 1.5 per cent. The Community has earmarked significant sums to help with funding pilot industrial and demonstration projects on, inter alia, alternative energy sources, the substitution of hydrocarbons and the liquefaction and gasification of solid fuels.
- 11.9 By 1990 it is estimated that consumption of oil will have fallen to 42.4% of total requirements, 75% of this being imported. Solid fuels will account for 24.7% of consumption; nuclear energy for 12.5%; natural gas for 18.1%; and other sources 2.3%. (Electricity, as a secondary fuel requiring other fuels to power the generation process is excluded from these figures.)

(b) *Rational use of energy*

- 11.10 Under this broad heading the Community seeks to direct the use of fuels to those functions for which they are best suited: coal and nuclear fuels for generating electricity; oil for transportation; and natural gas for domestic heating.
- 11.11 The rational use of fuels depends on their prices. But if fuels are priced differently in the different Member States, the signals to consumers and investors will vary. In pursuit of a more uniform pricing policy across the Community, recommendations have been issued, two of them so far on natural gas and electricity. The philosophy behind the recommendations is that prices must be "realistic", meaning:
- "... that the consumer must bear in full the cost of supplying him with energy, including the full long-run cost of production and distribution or of acquisition on world markets. It also means that costs must be allocated fairly between different categories of consumer. Government intervention in the form of financial support to energy suppliers or consumers is to be discouraged, except where such policies are agreed at Community level to be in accordance with Community policy and with other rules of the Common Market."<sup>1</sup>
- 11.12 In practice "realistic" prices amount to high prices. Such realism is not easy to apply, since prices generally reflect a host of legitimate social, industrial and fiscal considerations, but not the degree of scarci-

<sup>1</sup>Communications by the Commission to the Council, Com (82) 651 final, 19 October 1982.

ty of particular forms of energy. The institutions of the Community should not lend themselves to attempts to insulate consumers from the true cost of energy, particularly where a political as well as a financial price has been paid for it. The Commission is responsible for preventing distortions of the market through discriminatory and uncompetitive pricing. Greater effort is required to bring Member States who "cheat" in their pricing policy into line. Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings should facilitate enforcement.

11.13 Substantial economies are available to Member States, businesses and domestic consumers that undertake conservation measures. By 1990 the Commission estimates that conservation projects could yield between 130 and 150 mtoe (million tons oil equivalent) per annum, representing approximately 13% of current energy consumption and nearly one-third of current oil consumption. These estimates are modest; the extent of potential savings remains enormous. Community action in this sphere is limited to pinpointing areas in which improvements may occur and to making recommendations.

#### (c) Security of Supply

11.14 The moral of the 1973 crisis, relearned in 1979, was that Western States must not put themselves at the mercy of a particular supplier, or group of suppliers. Account must be taken therefore, of the political stability of a supplier when commercial relations are under discussion. For this reason imported oil, concentrated as it is in the Middle East, is to be discouraged. Conversely, coal is widely dispersed and its suppliers are politically reliable; moreover, proven coal reserves are vast. Coal is therefore, *ceteris paribus*, preferable to oil. Input materials for nuclear fuel generation are likewise secure. We feel concern at the growing dependence of certain Member States on natural gas from the USSR and from Algeria. To offset this, the Community and the IEA should encourage the exploitation of the very large reserves of Norwegian natural gas by providing the purchasing guarantees that are required for such an undertaking to be economically feasible. Generally, security of supply should be viewed in its wider context of OECD and Euro-American relations. It is certainly an issue with strategic dimensions beyond energy policy.

11.15 Consideration will have to be given, in the not too distant future, to the large scale transformation of coal into oil and gas. The technology for doing this exists; the market conditions necessary for commercial production do not. The Community has commenced funding research into liquefaction and gasification projects in the interests of long-term forward planning.

11.16 There can never be complete security of supply. The Community

must, therefore, be fore-armed to respond to a future supply crisis. Currently, Member States are required to stockpile 90 days' supplies of oil and 30 days' supplies of natural gas, which it may be possible to increase by 50-100%. Stockpiling measures of this nature should be undertaken on the widest possible basis, and especially by all members of the IEA.

11.17 A recent Council Decision No 77/186/EEC provides that, in the event of a serious shortfall, Member States should, so far as possible, maintain normal trading relations, thereby satisfying commercial oil and petroleum needs. Only in the event of a serious crisis are Member States entitled to impose export licensing schemes and subject these to restrictive quotas. Even then, restrictions on exports may only be imposed following consultations at Community level. Other Community measures designed to curb consumption during a crisis provide for drawing on buffer stocks, restrictions on consumers and the regulation of prices.

#### (iii) The Environmental Dimension

11.18 The "Green" parties that have emerged as a force in Western European and especially West German politics attest to the emotive nature of the environmental question and represent interests that must be reconciled with related economic issues. The priorities and scarcer resources of recession have caused reconsideration of environmental measures. In considering such cases as 'acid rain', lead in petrol and nuclear power, environmental measures must take account of the financial and restructuring burdens they impose upon commercial operators and of how such a burden will harm their international competitiveness.

#### (iv) The Future in the Medium Term

11.19 In a Resolution of June 1980 the Council elaborated five principal objectives for 1990:

- (a) Reduction to 0.7 or less of the average ratio between growth in gross primary energy demand and the rate of growth of gross domestic product (GDP). Thus for every one unit of growth in GDP there should be only a 0.7 unit growth in energy consumption. Current estimates indicate that this target for dissociating economic growth and energy consumption will be met.
- (b) Reduction in the use of oil to about 40% of gross primary energy consumption. Forecasts for 1990 put consumption of oil at about 42% of gross primary consumption.
- (c) Expansion in the use of solid fuels and nuclear energy so as to account for 75% of electricity generation.

- (d) Expanded use of renewable sources to account for 2.3% of consumption.
- (c) Adoption of realistic pricing for fuel in order to discourage profligate use and transmit accurate signals to consumers and investors, thereby enabling them to make rational decisions as to use and investment.

These objectives are modest but attainable and we support them.

11.20 In order to place the Community's energy policy on a more secure financial basis, the introduction of an energy tax on fuel consumption has been proposed. Such a levy would seek to dissociate the evolution on an effective energy policy from the recurrent budgetary and related political problems which bedevil so many Community plans, including, in the past, energy policy.

11.21 The tax would redress the imbalance between fuels, which presently attract no duty on entering the Community, and other products. And it would help to deter consumers from relying upon imports. The amount sought to be raised by the tax suggests that its level of application to consumers would be small: well below 1% if applied to consumers of all fuels whether imported or domestically produced; and fractionally above 1% if levied on consumption of imported fuel only. Such a tax would, however, undoubtedly offend against the principles of free trade upon which the Community is based. It would be unpopular with energy suppliers and industrial consumers; and it would be vulnerable to unlimited increases in the future on irrational protectionist or mercantilist grounds. On balance, therefore, we reject it.

## 12. THE COMMON AGRICULTURAL POLICY

### (i) General

- 12.1 This chapter is based on the following assumptions:
- (a) The Community will consist of twelve Member States (i.e. the present Ten plus Portugal and Spain). The accession of Turkey, whose population could well exceed 70 million by the year 2000, would make a substantial difference in a number of agricultural sectors, but no attempt at an assessment is offered here.
  - (b) Within a Community of Twelve (population 320-330 million) the move away from employment in agriculture which has been so marked a feature of the post-war years will diminish overall, but it will still be significant in Greece, Portugal, and Spain. However, this projection will depend on the state of the European economy, i.e. on opportunities for employment in sectors other than agriculture.
  - (c) Biotechnological research on both plants and farm animals will continue to make higher yields possible in respect of most pro-

ducts. Advances will also continue to be made in lowering costs and improving machinery.

- (d) The institutional structure within which the CAP operates will remain broadly unchanged. It is, however, possible that expenditure on the CAP might become "non-obligatory", i.e. subject to a much greater degree of control by the European Parliament.

12.2 The CAP is already characterised by a degree of tension between producers in the North of the Community and those in the South. This is likely to continue. Enlargement will serve to increase the political weight of the South, and a further element in the divergence of interests is the fact that environmentalist pressures (see paragraph 8 below) will be stronger in the North. Overall, agriculture's contribution to GDP is likely to decline, and in the long term the Community's institutions (which presently bear the financial consequences of Member State's agricultural decisions but have little say in the overall strategy) can be expected to exercise greater control.

### (ii) Reform

12.3. The basic principles of the CAP, as set out in Article 39 of the EEC Treaty are unlikely to be changed. The emphasis will be on reforming the mechanics of the CAP, notably in respect of:

- (a) the open-endedness of price support, at least for products in surplus;
- (b) the lack of coordination between the annual price-fixing and the general economic situation in the Community;
- (c) the use of CAP to pursue non-agricultural (mainly social) purposes;
- (d) the impact of the CAP on the environment.

12.4. In the short term, price support for products in surplus could be made subject to specific limitations on quantity. But it is difficult to imagine how this might be done without a significant increase in administrative costs, unless there is to be considerable scope for fraud (though this is only a problem in some Member States, not including Britain). Within twenty years, we can expect surplus production to have been brought under control. Already, the difficulties posed by this aspect of the CAP have very effectively discouraged any suggestion that price support on the scale accorded to temperate products should be extended, on further enlargement, to Mediterranean products. If a system of support were to be introduced for those products, these might have to take the form of deficiency payments.

12.5. Price-fixing is the most politically sensitive aspect of the CAP; and will probably continue to be so, if only because agricultural lobbies are likely to remain more powerful than consumers' organisations. As a short-term measure to bring decisions on pricing in the Council of

Agricultural Ministers into line with general economic policy, guidelines for decisions should be laid down with Finance Ministers. This is fundamental to the long-term aim of matching the Community's financial commitments to its financial resources. Although provision would always have to be made for short-term review, it should be possible, and we think it desirable, to move away from the present rigidly annual price-fixing procedure, consistently with a move towards multi-annual estimates for the whole Community Budget.

12.6 The system of "Monetary Compensatory Amounts" was designed to protect those trading in agricultural products within the Community from the effect of fluctuations in the exchange rate. However, the "green currencies" have in practice operated as a subsidy to some producers (notably those in West Germany) as a consequence of the control which individual Governments exercise, for political reasons, over the rates. This causes further distortions and disequilibria in agricultural market. In the long term we recommend the abolition of MCAs.

12.7 The CAP fulfills a number of functions which are not purely agricultural but rather social or regional. One possibility might be to return those functions to the care of the individual Member States. This could very easily result in the progressive renationalisation of the CAP, since it would inevitably undermine such control as the Commission exercises over national aids, and so destroy the unity of the market. A better course, we believe, would be for some explicit recognition to be given to the non-agricultural functions performed by the CAP; and for these to be better coordinated with other Community funds, perhaps as part of a comprehensive rural policy. This would make it easier to adjust the CAP to take account of the concerns now being expressed about its impact upon the environment.

### (iii) Future Concerns

12.8 Public concern about the relation between agricultural policy and the environment is considerable, and in some Member States, the activities of "Green" parties have brought the issue to the forefront of politics. Concern, which extends of course to animal welfare, is likely to grow; and in the longer term there is little doubt that the CAP will have to take account of it, at least in the North of the Community, particularly in organising incentives to production. However, sophisticated herbicides and pesticides, and the intensive use of land associated with high productivity, which represent the main threats to the rural environment, may decline in importance for other reasons (see below).

12.9 Within the Community, we can expect a steady growth in public demand for a wide range of foodstuffs, and this should help to keep the frontiers open. Health standards, testing procedures, and legislation on

packaging and labelling must be harmonised in the short term to maximise the free flow of agricultural products. In external trade the Community must avoid the indiscriminate disposal of surpluses in third country markets. Protectionist tendencies over imports should be kept in check by the realisation that many developing countries we are anxious to help are dependent on their agricultural exports to the Community; and that we can ill afford to offend other food-exporting countries which are important customers for our manufactured goods. The Community is likely to remain the world's largest food importer. Exports, too, are likely to show a steady increase. And these two facts underline the very strong interest the Community has in bringing a greater degree of stability to the food markets of the world.

12.10 The share of food in household expenditure is likely to decline further. However, the growth in popularity of convenience foods, with their high added value, will partially compensate for this. The proportion of agricultural products which undergo some form of processing before reaching the consumer (approximately two-thirds of the total today) will slowly increase, with important consequences for the food industry. In some countries, the purchasing power of the multiple retailers is starting to affect agricultural producers' profits, which are already under pressure as a result of higher input costs (see below).

12.11 Over the last ten years, there have been steep increases in input costs, particularly in oil-based pesticides, fertilisers, feeding stuffs, etc. "Efficient" farming has tended to mean high yields achieved by high inputs in large units. The price of oil should remain relatively stable in the immediate future, but in spite of this, farmers all over the Community are being urged to maintain their profits by economising on input costs rather than increasing output. This is where the main emphasis of research now lies, and in general terms, we are likely to see these costs contained across the Community. However, in Member States where farming methods are less sophisticated, input costs, especially labour costs, will continue to increase quite rapidly, thus eroding one of the major comparative advantages which such countries presently enjoy.

12.12 Farm incomes are now falling quite rapidly by comparison with incomes generally. Given that the move away from employment on the land is, in most Member States, nearing completion; that the Community's population is stable; that expenditure on food is declining relative to personal expenditure overall; that there are major obstacles to the expansion of the Community's food exports; and that levels of public subsidy are already causing concern, serious political tension over the level of agricultural incomes in the next twenty years seems inevitable.

12.13 The Community's agricultural production over the past two decades has been increasing three to four times more rapidly than consumption. Self-sufficiency has been achieved in the majority of temperate products; and with enlargement, this can be extended still



further (to the disadvantage of some traditional suppliers). The size of the Community's population is such that, at least as far as the main products are concerned, buying on the world market is risky and for the foreseeable future there can be no alternative to our supplying most of our own needs.

(iv) *Conclusion*

- 12.14 In an uncertain world threatened in the longer term with food shortages, self-sufficiency in the main agricultural products is an immense advantage. Both now and for the future, the Community's capacity to feed itself is assured: were it otherwise, that would indeed be indicative of failure. What has gone wrong with the CAP is not that it has failed in its original five objectives but that its success in achieving the first objective - increasing agricultural productivity - has far outstripped the others in a way for which the policy itself makes no provision. The nature of the price support mechanism is such that any kind of brake on increases in productivity places the policy's other objectives in jeopardy.
- 12.15 The conclusion must be that the price support mechanism alone may not be enough. Whatever the difficulties involved an element of direct income support may be necessary.
- 12.16 The CAP we should be working towards must be one in which the basic internal contradictions have been resolved; which is supplemented by a judicious food strategy worked out in conjunction with the other major food traders; which is characterised by fair competition between the different food producers within the Community; and in which the main interests - producers, consumers, agricultural workers, taxpayers - are kept broadly in balance.

### 13. THE COMMUNITY'S FINANCES

(i) *"Own Resources"*

- 13.1 The present system of financing the Community budget was decided in 1970 when the Community still consisted of six members. It provides the Community with own resources composed of agricultural and sugar levies, customs duties and up to 1% of a harmonised VAT base. On the eve of a further enlargement of the Community to include Spain and Portugal, the Community is living under the threat of the exhaustion of its financial resources. For 1983 virtually all available resources were taken up. For 1984, the resources currently available to the Community will not be sufficient to finance the policies already agreed in the Council of Ministers. What is at stake is thus nothing less than the preservation and normal operation of those existing and

potential Community policies which cost money. The original purpose of the present system of own resources was to provide security and continuity of these policies. It cannot be allowed to become a permanent threat to their operation.

- 13.2 When the present system was set up in 1970, the aspirations of the Community were a balanced development of its policies in a number of fields, agricultural as well as regional, social and industrial policies. As it has turned out, agricultural spending has maintained a predominant part in the Community budget. In consequence, the Community institutions have been faced during the last four years with the problem of budgetary imbalances which could only be solved by *ad hoc* compensatory arrangements.
- 13.3 There are good reasons why the development of Community policies should not and need not conflict with the imperative for budgetary stringency. Action at Community level should achieve more cost-effective solutions to the problems of Member States than could be offered in purely national programmes. Many of the most urgent tasks which now face the Community would cost little or nothing. The removal of barriers to trade in manufactures; the free trading of services; cooperation between companies in research, development and production; the strengthening of cooperation in foreign affairs and security; the further coordination of monetary and exchange rate policies - none of these vital objectives for the Community would make any substantial budgetary demands. Rigorous procedures of financial discipline should be applied to all Community policies - new and old. The Commission has recently proposed ways for achieving this which deserve close study. This British Government has been a pioneer in the drive for financial discipline in the Community. It should spare no effort to pursue that cause to the end - even after a settlement to the problem of British contributions to the Community budget is found. The Common Agricultural Policy must not be excluded from this. The growth in agricultural expenditure should, under all circumstances, be kept *below* the growth in the Community's financial resources in the years ahead.
- 13.4 The principle of efficiency at the level of the Community will not however, remove its need for new resources. Enlargement of the Community to include Spain and Portugal may require additional resources amounting to at least 5% of the Community budget. The costs of the Common Agricultural Policy will continue to rise unless reforms are undertaken by the Council of Ministers which are far more drastic than those which it has already made. New areas of Community policy, where spending can be justified by greater efficiency, must be financed.
- 13.5 We therefore believe an increase in the Community's resources to be justified. The European Council, at its meeting in Brussels in March

1984, agreed in principle that this ought to be done by raising the ceiling on VAT contributions from 1% to 1.4%, and thence to 1.6%. We believe this to be an appropriate way of raising new resources at the present stage of the Community's development. Before money can actually be spent, a formal decision by the Council is necessary; so the British, or any other government is in a position to block expenditure. In addition, the European Parliament exercises significant influence over most areas of Community expenditure except agriculture and one or two very small items. Members of the European Parliament have an opportunity to rally support against unnecessary or damaging proposals for expenditure.

(ii) *Britain and the Community Budget*

- 13.6 The United Kingdom is currently making an annual payment to the Community Budget (before refunds) of about £1.2 billion or 2 billion ECU. This is the net transfer of money from the United Kingdom into accounts held by the Commission in other Member States. The figure represents about 0.5% of GDP, or 3% on the basic rate of income tax.
- 13.7 Although the United Kingdom is one of the poorer Member States, our percentage contribution to own resources exceeds our percentage share of Community GDP. We pay relatively more levies and duties on imports, because a higher proportion of imports still come from outside the Community than is the case with other Member States. This is despite a substantial change in trade patterns since accession: well over 40% of the United Kingdom's trade is now with other Member States, compared with under 30% before we joined. In agriculture, the shift has been even greater: nearly 50% of our agricultural imports now come from the Community, compared with only 31% before accession.
- 13.8 The United Kingdom obtains only about 11% of the Guarantee Section of the CAP. The CAP absorbs two-thirds of Community expenditure compared with 13% on the Regional and Social Funds, 5% on refunds to the United Kingdom and West Germany, and 4% on aid. United Kingdom agriculture accounts for 3% of employment and 2.5% of GDP, compared with 8% of employment and nearly 5% of GDP in France.
- 13.9 There is no indication that there will be any change in Britain's relatively large net contribution to the Community budget unless the balance of existing Community policies is radically changed and/or the revenue side of the Budget is reformed. The own resources decision of 1970 was taken despite representation from the United Kingdom that after entry it would impose considerable burdens upon us. During the negotiations for the British accession, the Commission argued that agriculture would fall as a share of the total budget to about 40%. A

paper submitted by the Council of Ministers of the Six to the United Kingdom on 4 November 1970 gave the important assurance that "should unacceptable situations arise within the present Community or an enlarged Community, the very survival of the Community would demand that the institutions find equitable solutions". The full extent of Britain's budget problem only became apparent towards the end of the five-year transitional period. In 1979 Britain was faced with a net contribution of £1.2 billion. The incoming Conservative Government negotiated an *ad hoc* refund on a three-year basis of about two-thirds of the net contribution (about £2.5 billion). At the same time the Government set about negotiating a long-term solution to the problem.

- 13.10 The Budget problem is closely bound up with the long-term development of the Community. Any community, if it is to last, must place its finances on a footing which the members, be they individuals, provinces, or sovereign states, consider equitable. The British Government has consistently held that equity should be attained by relating contributions to the ability to pay. However, both the amount of the disparities (see below) and the principle that disparities should be corrected were disputed by other Member States. In particular, it was argued that to redress the United Kingdom's grievance would undermine the own resources system whereby certain monies are, under the Treaty, the Community's and not the Member States'. Not only is the question of budgetary imbalances central to the durability of the Community; it is also holding up development. Over the last few years it has dissipated the energies of senior Ministers and Heads of Government and distracted their attention from a wide range of other proposals, many of which are discussed in this paper.
- 13.11 In addition to the criteria of equity and durability, any solution would require agreement on a system of measurement of the imbalances.
- 13.12 The British position has always been that the figure for net contributions is best measured by the net transfer of money to accounts held by the Commission in other Member States. On the revenue side (alleged excessive contributions of customs duties and agricultural levies) it was argued that many goods are in fact consumed in another country. This is extremely difficult to measure and the argument has always had an academic rather than practical stamp. It was also argued that excessive contributions in the form of levies and duties were the United Kingdom's own fault since we were importing too much from outside the Community; but the massive switch to trade within the Community since Britain's accession has severely weakened this argument. On the expenditure side, various alternative methods of measuring the benefits of FEOGA to British farmers were suggested. During the negotiations, the United Kingdom tacitly conceded the arguments on the revenue side by agreeing to omit customs duties and levies from

the sum agreed as the net contribution. At the same time, other Member States tacitly accepted that contributions should reflect ability to pay and that VAT transfers across the exchanges were a suitable measure of those conditions.

- 13.13 It is preferable to implement any mechanism to redress imbalances on the revenue side, since spending would have to be increased many times for the imbalance to be rectified on the expenditure side. For example, it has been estimated that under the existing quota arrangements of the regional policy, expenditure would have to be increased thirty times for Britain's net contribution to be reduced to zero. After enlargement to include two countries with very considerable regional problems, it is unlikely that any given level of expansion of existing policies which are at present favourable to Britain could ever reasonably solve the problem.
- 13.14 A second argument against any solution on the expenditure side is that implementation of such measures would almost certainly be obstructed by the European Parliament.
- 13.15 After the Stuttgart Summit at which agreement was finally reached on the need to tackle these problems, the British delegation tabled a "safety net proposal" to a Special Council meeting held before the Athens Summit. This may be summarised as follows:
- (i) the Community would agree that Member States below a certain level of relative prosperity should be net beneficiaries from the Budget and not in any circumstances net contributors;
  - (ii) above that level, the limit on a Member State's net budgetary burden could be expressed as a small percentage rising progressively according to the Member State's relative prosperity;
  - (iii) any Member State whose net budgetary burden as measured by the Commission exceeded its agreed limit would have its VAT payments in the following year reduced by the amount of the excess.
- 13.16 An alternative solution which could benefit the United Kingdom would be to reduce levels of expenditure in those areas where Britain does not benefit as much as most other Member States, in particular FEOGA spending. Two-thirds of the United Kingdom's budgetary imbalances are generated on the expenditure side, largely by the CAP, and only one third on the revenue side. Although theoretically plausible, it would be clearly unrealistic in the short term to expect the fundamental reform of the CAP required to achieve this. Nevertheless, along with the safety net proposal, the Government also tabled a proposal for a firm financial guideline to limit Community expenditure in any given year, to be set at the beginning of the year. The financial guideline would be embodied in the budgetary procedures of the Community to ensure that the rate of growth of agricultural spending was markedly less than that of the Community's services.

- 13.17 The financial guideline should be seen as a proposal intended to place the Community's finances on a durable basis rather than as part of Britain's attempts to redress budgetary imbalances. It is wrong for the Community to conduct its finances in a profligate manner.

*(iii) The Settlement under negotiation*

- 13.18 Although it has taken far too long, most Member States have reconciled themselves to the need to tackle budgetary imbalances and to achieve greater budgetary control. Despite appearances to the contrary, a major step forward was made at the Brussels Summit. The French proposals tabled there closely mirrored the United Kingdom's delegation's submissions before the Athens Council.
- 13.19 After the Brussels Summit, the Foreign Ministers met to discuss the budgetary mechanism, a variant of the British and French proposals. Under this system net contributions would be measured by three criteria: the threshold; the surcharge; and the difference between the burden on the United Kingdom as we had measured it in the past and as it would now be measured (the so-called "VAT expenditure gap").
- 13.20 The threshold would represent a level of net contribution calculated as a small percentage of GDP, which sets what was originally hoped might be an absolute ceiling on net contributions. The United Kingdom's important point of principle, that contributions should be related to the ability to pay, measured by GDP, would then be met. The surcharge would represent a percentage of what remains between the threshold and our unadjusted net contribution. The percentage has not yet been agreed. The third element, "the VAT expenditure gap" is still the subject of intensive negotiation. This element would measure the difference between a Member State's share in VAT payments during the year and its share in allocated budgetary expenditure and express this as a percentage figure which could then be applied to the total allocated budget. This would leave levies and duties out of account, because it has been argued all along by other Member States that in a customs union levies and duties levied at national borders are not national revenue but are Community revenue from the outset.
- 13.21 At the time of going to press, the negotiations were still in progress.

## 14. EUROPEAN POLITICAL COOPERATION AND DEFENCE

### 1 EUROPEAN POLITICAL COOPERATION

#### (i) *The Need for European Political Cooperation*

- 14.1 The political aspects of membership of the European Community played an important part in the debate about Britain's entry before 1973 and during the Referendum campaign two years later. There is a tendency to forget that the long-standing opposition of Britain's extreme Left towards the European Community was at least partly based on their fear that the successful "rich man's club" of the six would become a powerful political bloc which would resist moves to create a demilitarised, neutral Europe. Since 1973, public debate about Britain's role in Europe has concentrated upon economic rather than political problems, so that the progress made in European Political Cooperation (EPC) has not been widely recognised.
- 14.2 The need for closer cooperation in foreign policy reflects the changing balance in the post-war world. The Member States of the Community are a group of comparatively small nations whose relative economic strength is coupled with considerable geographic vulnerability. Western Europe is not only on the "front line" of any future world conflict, but is also dependent on extended supply lines for raw materials which stretch round the world. That vulnerability has increased since the signature of the EEC Treaty in 1957. Events in South East Asia, Afghanistan and elsewhere represent serious setbacks for the West. New threats to the interests of Western Europe include the employment by the Soviet Union of surrogates, such as Cuba, to intervene directly in areas whose position and resources are of key strategic importance; a military build up unprecedented in peace-time; and an intensified campaign to influence and encourage certain political movements, most recently "peace movements" in Europe. The protection of the worldwide interests of the Member States can only be achieved through joint action. Both the need for closer coordination of policy with the United States, for example in the Middle East, and the prospect of further enlargement of the Community, make a commitment to strengthen EPC essential.
- 14.3 There are several respects in which the European Community could play a fuller part in international affairs. Many Member States retain close historical ties with third countries. The countries of the Community, taken together, form the largest trading block in the world and make the greatest contribution to the development of Third World countries.

1982 Figures:

	Share of World Trade	Share of Aid
European Community	21%	35%
United States	15%	16%
Japan	9%	9%
USSR	5%	6%

- 14.4 The division of responsibilities within the Commission, separating trade, aid, agriculture and other areas which have an international dimension, has tended to produce not only conflicting policies overall but also a confusing set of attitudes towards individual third countries. (Ethiopia is a case in point). While the Commission has been devoting a considerable proportion of its development budget to Ethiopia, it has been pursuing agricultural and food aid policies which often run counter to the interests of very poor countries; and within EPC, the Foreign Ministers and the European Parliament have shown concern about the human rights record and other policies of the Ethiopian Government, one of the Soviet Union's closest allies in the region.
- (ii) *The Machinery of EPC*
- 14.5 Political Cooperation has never been within the competence of the EEC Treaty. In 1961 the Heads of Government appointed a committee under Christian Fouchet to draw up a plan for loose cooperation in foreign, defence and cultural policy. Negotiations on the Fouchet Plan broke down in 1963, partly over whether or not to include the United Kingdom. The Luxembourg Report in 1970 set out to ensure the exchange of information and regular consultation, and, where desirable, common action.
- 14.6 Political Cooperation has always relied upon consensus. Following the Copenhagen Report in 1972, EPC matters have come to be discussed much more frequently than was originally envisaged. Normally, meetings of the Foreign Ministers in the context of EPC take place four times a year; but there are much more frequent meetings of the Political Directors from each Member State, and EPC matters are now regularly discussed at meetings of the Council of Foreign Ministers; as well as at meetings of the European Council. The Euronet communications system allows rapid exchanges of confidential information between the Member States. Consultation between representatives of the Ten in third countries has also become a normal feature of diplomatic life.
- 14.7 The day to day organisation of EPC revolves around the Member State holding the Presidency. However, the six-monthly rotation of the Presidency became an obstacle to longer term initiatives, especially since EPC operated outside any existing Community institutions and depended upon the manpower and resources of the Presidency itself.

In 1981, during Britain's Presidency, the London Report was concluded. Inspired by a Conservative initiative in the European Parliament, the Report sought to correct several shortcomings which had become particularly apparent at the time of the invasion of Afghanistan. The improvements included the following:

- (a) the introduction of an emergency procedure for rapid consultation in the event of a crises;
- (b) the introduction of a small supporting staff for the Presidency provided by the "Troika" of the preceding, the incumbent and the succeeding Presidencies, and other measures to improve continuity;
- (c) the formal inclusion of political aspects of security within the scope of EPC;
- (d) the inclusion of the Commission at all levels of the work of EPC; and
- (e) a commitment to seek to "shape events and not merely to react to them".

11.8 Despite the London Report, longer term initiatives are still difficult to sustain, as the lack of progress on the Middle East since the Venice Declaration of June 1980 clearly states. During the Greek Presidency, the Ten were reminded that cooperation is severely hampered by ideological divisions within the Community. Arms procurement is discussed by the Parliament but still not by the Foreign Ministers. The machinery of EPC does not shape events and too often fails to anticipate them, especially in relations with the United States. The solemn Declaration of European Union, signed in June 1983 by the Heads of Government, was not especially encouraging; so many of its recommendations had already been expressed in previous Reports on EPC. Only a few months afterwards, the Member States were unable to issue a joint condemnation of the shooting down of the Korean airliner. Although a small seconded staff based on the "Troika" has been set up, there is a case for improving on this. Smaller Member States have special difficulties when running the Presidency of the Community, and a small number of staff from each Member State seconded from their respective Foreign Offices would be useful, although it is recommended that the prominence given to the "Troika" member states should continue.

11.9 Nevertheless, the successes of EPC should not be overlooked. Its most outstanding achievement, in many ways, has been its ability to grow in strength during a period when the evolution of policy under the EEC Treaty was at best stagnant. The members of the Community are seen as a single bloc by third countries. It was a Community proposal at the end of the Madrid Conference which provided the basis for the present disarmament conference in Stockholm. In the United Nations, the Ten vote together much more often than they are divided. At the time of the invasion of the Falklands Islands, the new emergency

procedure was invoked: within days the Member States had not simply agreed upon a joint reaction, but had taken action under the Treaty to impose a trade and arms embargo. The Falklands crisis suggests that EPC need not amount to "procedure as substitute for policy".

### (iii) A Medium Term Agenda

14.10 Since there will always be occasions when individual Member States' interests are not parallel to those of the Ten, it is unlikely that EPC could ever develop without a consensus on all major decisions. Britain's traditionally close links with the Commonwealth or the United States would be an asset to a strengthened system of EPC and should not be adversely affected by moves towards a common foreign policy.

14.11 The Soviet Union has never taken the view that "detente" is synonymous with the abandonment of attempts to undermine the allies of the West. The need for the Community to develop a stronger and more coherent attitude towards the defence of European interests around the world is unlikely to diminish. If the Community's economic and political decisions were to become more consistent with each other there would be a better basis for the development of closer contact between East and West. Two spheres of enormous political importance, which should be taken into account by a Community foreign policy, are: the protection of Europe's supplies of raw materials, especially sea lanes and coastlines; and the presentation of defence policies to the electorate. In addition, the Community could make a contribution towards limiting the cost of modern weapon systems. If resources were pooled for certain high technology research and development programmes, benefits would accrue to both the civil and military sectors of industry. Division of labour in arms production between the United States and the Community has been discussed for many years; but the inability of the European armaments industries to rationalise their production has prevented European dependence on the United States from becoming interdependence. Unless the Community can compete by specialising, weapons produced in Europe will become prohibitively expensive.

14.12 The Soviet Union can be expected to continue encouraging division between Western Europe and the United States. It is incumbent upon those Western European nations working within EPC to ensure that, where points of difference occur, they are, as far as possible, anticipated, and a constructive *joint position* is agreed. The United States would not then be obliged to accommodate ten different reactions to the same problem. The initiation of contacts at cabinet level between the administration of the United States and the Commission to discuss economic problems may be a useful precedent for EPC.

14.13 The enlargement of the Community to include Greece was followed, shortly afterwards, by the election of a left-wing Socialist Government in Greece. Further enlargement of the Community may increase the likelihood of ideological as well as national differences preventing unanimous agreement being reached for the purposes of EPC. Commitment to strengthening EPC by the existing Member States in advance of enlargement is probably the only safeguard against such an eventuality. The entry of Spain and Portugal will bring with it closer ties between the Community and Latin America. This should be welcomed, although it may pose temporary difficulties for Britain and her responsibilities towards the Falklands.

14.14 The peace-keeping operation in the Lebanon would undoubtedly have been more successful if France, Britain and Italy had been supported by a Community policy. Although Lebanon had been on the agenda of the Foreign Ministers for nearly every meeting in the preceding year, no policy emerged. Stability in the Middle East is in some respects more important for the Community than it is for the United States. This fact is unfortunately not reflected in the responsibility the Community shoulders for pursuing peace, compared to that borne by the United States. The Community should not need terrorist outrages in its own capitals to mobilise the machinery of EPC.

14.15 A common foreign policy should not be seen as equivalent to common policies in other areas. It should be based on the existing machinery for EPC.

14.16 A common foreign policy should not be seen as equivalent to common policies in other areas. It should be based on the existing machinery for EPC which is outside the Treaty and requires unanimous decision-taking. The test of a successful common policy would not be agreement on joint positions on every issue; but, rather, whether events were shaped and anticipated effectively; whether the establishment of independent positions by Member States occurred only after consultation with all the other partners; and whether the Community comes to fulfill its potential as a powerful force for the defence of its members' interests around the world.

## II DEFENCE

### (i) *The Present Debate*

14.17 A wider debate about European security and defence has continued, at different levels of intensity, throughout the last thirty years of NATO's history. There are still many in Europe who look back further to what "might have been" if the European Defence Community had got off the ground. Current debate, however, focuses on the question

how far Europe can or should bear a greater part of the burden of her own defence. It is possible to distinguish three different schools of thought: those who are "Atlanticists", believing that the relationship with the United States established in the early years of the Alliance should be regained and reinforced; those who are "Neutralists", believing that Europe should disengage from the United States without providing adequate defences of her own; and those who are "Europeanists", believing that, if Europe wishes to recapture a greater measure of self-respect, she must come to terms with the greater cost and political difficulties associated with depending less heavily on the United States.

14.18 Most "Europeanists" look for some sort of European institutional structure which would be capable of coordinating and maintaining a new European defence effort. The French Government is believed to favour a revamped Western European Union; others look to a larger role for the "Eurogroup" within NATO, for the Independent European Programme Group or for the Community or some part of it; for collaboration between the nation states. Such proposals have been met with serious criticism from "Atlanticists". Will European Governments during a period of recession really face up to the enormous opposition which would be engendered by considerable increases in defence expenditure? Will European governments be prepared to abandon a proven system for the defence of Western Europe in favour of a new European venture which could be risky, even inoperable, if the history of Europe so far is any guide? Assuming that Western Europe would still depend upon the United States' strategic nuclear umbrella, methods for reconciling differences between Europe and the United States would still have to be found; and would not a newly "independent" Europe be less than willing to make the kind of compromises required? Above all, would a new structure for the defence of Western Europe, based on some new European component and American nuclear guarantees amount to a sufficiently credible deterrent to the Soviet Union?

14.19 A fourth option would be to see how the present structure of the European Community could contribute to overcoming some of NATO's most pressing difficulties. It would not involve a new relationship between Europe and the United States or the construction of new European defence institutions, but the European Community would be more aware of the contribution it could, already, be making to the durability and viability of the Alliance. Over a period of twenty years this may be the most that can be hoped for.

14.20 The Ottawa Declaration, signed in June 1974, highlighted the connection between greater political unity within Europe and a greater European contribution to Western defence: "It is also recognised that the further progress towards unity, which the Member States of the

European Community are determined to make, should in due course have a beneficial effect on the contribution to the common defence of the Alliance of those of them who belong to it". In the 1980s relations between the Members of the Community and the United States have become very complex and dangerously accident-prone. The "frank and timely consultations" advocated in the Ottawa Declaration have not always been frank or timely enough.

*(ii) A European Contribution*

- 14.21 Greater emphasis on conventional forces, of which the European allies now contribute 80%, is likely because it is the Soviet Union's overwhelming superiority in conventional forces that makes Western Europe's position so precarious. Indirectly, the Community could do a great deal to make Europe's conventional defences cheaper and more effective. Essential research teams should not depend for their survival on the placement of a single defence order. Already the "Big Twelve" informatics firms in Europe are coming together to produce common standards and take advantage of the wider European market. The Community should promote similar developments in other high technology industries, a move which would benefit military and civil sectors alike.
- 14.22 There is much discussion of possible future Franco-German defence cooperation and Anglo-French nuclear cooperation. Such bilateral initiatives are not, in the first instance, a concern of the European Community. However, the Community could mitigate the one major disadvantage of bilateral initiatives: the resentment of allies who are not part of them. "Europeanists" argue that a continued divorce between foreign policy and security, on the one hand, and defence, on the other, within the Community countries would be prejudicial to the security of Europe. Serious moves towards Franco-German military cooperation would be likely to bring that issue to a head.
- 14.23 The need to persuade the electorates of Europe of the wisdom of NATO's strategy has never been greater. The Community has no direct contribution to make to this process. However, were the Community to make a serious attempt to assist defence-related research and development, and were the distinction between European security and European defence to become less sharp, the Foreign Ministers might find themselves having to explain and defend Community policy in the European Parliament. It would then be for Members of the European Parliament to return to their constituencies and explain the Community's role to their electorates.

## 15. DEVELOPMENT POLICY

- 15.1 Relations with developing countries are likely to emerge as one of the more important aspects of the Community's foreign policy during the next two decades. Europe's prosperity is bound up with the material progress of the 3,400 million people outside the fully industrialised countries. Apart from a moral commitment to help those living in intolerable poverty, the Community has a responsibility to promote freedom and democracy in the rest of the world. Developing countries take 40% of our exports and supply us with vital raw materials. Western Europe will increasingly benefit from the commercial opportunities created by industrial development and the growth of population in developing countries. Many of the latter are in the throes of an industrial revolution of unprecedented rapidity. It will be the Community's task to allay the unjustified, though deep-rooted, fears of many people within its Member States, and in the developing countries, and to convince them that free competition is the only rational policy for both sides. The function of aid should be to foster, not to hinder, self-reliance.
- 15.2 The Community's development policy sprang from the relations between the original six Member States, particularly France, and their former colonies. Through the Lomé Convention the Community has established a special relationship with most African, Caribbean and Pacific states. In addition, aid is provided to the poorer countries in Asia and Latin America through the Non-Associated aid programme. Food aid is given to many countries, both in response to emergencies and, more questionably, on a long-term basis. As recently as 1975, Community aid was confined to 19 African states. It now covers about 100 developing countries with almost 2,000 million inhabitants and amounts to 10% of total aid. In 1983, £1,298 million was distributed under Community programmes. If Member States' bilateral aid is included, the Community accounts for 35% of all resource transfers from the developed to the developing world.
- 15.3 As a result of initiatives from the European Parliament, the Community has recently begun to concentrate on agricultural development and self-sufficiency in food. While the Community is respected for its imaginative development policies, there are defects in the administration of the aid programme.
- 15.4 At a time when a more sceptical view of what aid can accomplish, together with the recession, have put an end to the steady rise in

<sup>1</sup> Among the major statements on Community development policy are the European Parliament's Ferrero report on *Hunger in the World* (1981), the Pisani Memorandum and the Parliament's Jackson report on the Memorandum (1983).

financial assistance, many countries are becoming more dependent on foreign aid. The combination of population growth, the oil crisis, disastrous economic policies, political instability and Western protectionism, have brought increasing poverty and greater food shortages. At the same time, governments are under pressure to satisfy the growing aspirations of their populations. Rural migration and consequent urban overcrowding have led to threats of civil unrest. However, experience since independence has made some governments more pragmatic in their approach to economic development.

15.5 Further liberalisation of trade must be given priority during the next 20 years. Adjustment will not be easy, particularly for those declining European industries subject to competition from developing countries. The Community may help to ease the transition to higher technology. If this redeployment of resources does not take place, the Community will be overtaken by more dynamic economies and we, as well as the developing countries, will suffer. Unemployment in the Community will be helped in the long run by stimulating the demand in developing countries for the goods and services which the Community is better equipped to provide by virtue of technological and entrepreneurial prowess. The Community's Generalised System of Preference (GSP) allows for reductions in customs duties or exemption, accompanied in certain cases by quotas for finished or semi-finished industrial products and processed agricultural products. Further liberalisation of the GSP system is essential, especially now that less inflationary and interventionist domestic economic policies have begun to restore growth. The protectionist legacy of the recession must be dismantled.

15.6 Another major instrument of the Community's trade policy is the STABEX system which seeks to stabilise export earnings in the primary sector. The Commission is attempting to make the scheme more effective, but it could lead to structural surpluses, and countries should not be allowed to become dependent on it.

15.7 Aid can only contribute to alleviating certain aspects of a country's problems, and then only if it is effectively administered both by donor and recipient. The Community needs to give far greater attention to evaluating the impact of aid on the economies of the recipients, so that resources may be concentrated on projects which give value for money. Further training and education are essential if developing countries are to produce the administrators and technicians they need. The Community is trying to introduce "policy dialogue" with the recipients of its aid; and these discussions might be extended to include internal Community policies with a direct impact on developing countries. To be really effective, such dialogue should also include the other donors working in each country, making it possible to devise programmes specifically suited to that country's needs.

15.8 The United Nation Fund for Population Activities has predicted a

38% increase in the world's population, from 4,432 to 6,119 million by the year 2000. Africa's population is expected to grow by 81% during this period, though the rate of increase in other hitherto rapidly multiplying countries is falling. A thousand million people are said to be suffering from malnutrition. While emergency food aid can provide short-term relief, it is certainly destructive if it becomes permanent. In the next 20 years priority must be given to providing the means for developing countries to feed themselves. Economic growth will reduce birth rates, but governments that wish to encourage population programmes should be offered help by the Community, as long as they respect religious scruples and human rights. Except in emergencies food aid should only be given to countries prepared to adjust their internal policies sufficiently to avoid dependence. Governments must realise the importance of incentives in determining the productivity of small farmers. The Commission is being made aware of the need to switch resources from food aid into agricultural projects; and if the Community's food surpluses are brought under control, this will become easier to implement.

15.9 We believe that the time is ripe for an independent review of development policy. The review should be carried out by a committee of distinguished individuals appointed by the European Council. Issues for the committee to consider would include: the division of responsibilities in this area between the Member States and the Community; whether some recipients of aid are now prosperous enough to manage without it; which countries, hitherto excluded, should be brought within the purview of the policy; the role of the European Investment Bank in providing concessionary loans; and ways in which private investment could reduce the need for official development assistance.

## 16 THE COMMUNITY'S INSTITUTIONS

### (i) General

16.1 The nature of the Community's institutions and the scope of their powers must be determined by the tasks the institutions are called upon to perform. The range and difficulty of those tasks, both internal and external, will be clear from previous chapters.

16.2 The main challenge is to find ways of improving the capacity of the institutions for taking the decisions that are urgently required in so many fields. In doing this, due regard must be paid to Governments' legitimate concern for what they see as vital national interests; and to the necessity of ensuring a proper degree of democratic accountability.



16.3 In the discussion that follows there are references to the "Solemn Declaration on European Union" which was signed at the meeting of the European Council in Stuttgart on 19 June 1983. The Stuttgart Declaration adopts a number of principles on the functioning of the institutions and on relations between them. It represented the response of the European Council to the rather more ambitious proposal for a European Act which was put forward in November 1981 by two of the Community's leading statesmen, Mr Genscher of Germany and Mr Colombo of Italy. We also refer to some of the institutional proposals in the Draft Treaty on European Union (DTEU), which has been drawn up on the initiative of the European Parliament and approved by a majority of its members.

(ii) *The European Council*

16.4 This is the name given to the meetings of Heads of State and of Government, together with the President of the Commission, which now takes place three times in each year.

The Treaties make no provision for the European Council as such. In the Stuttgart Declaration it is stated that "When the European Council acts in matters within the scope of the European Communities, it does so in its capacity as the Council within the meaning of the Treaties". That was always the legally correct position but it has now been put beyond argument.

16.5 European Councils are used primarily for three purposes: seeking solutions to issues on which the Council is having difficulty in making progress; laying down the broad lines of future policies for the Community; and holding talks on matters ranging beyond the Community, especially foreign policy. Experience suggests that a relatively brief meeting at the highest level of government is not well suited to resolving complex disputes like the one over Britain's contribution to the Budget; and failures are liable to be over-dramatised by the national media. The possibility of appealing to superior authority discourages the foreign ministers from taking hard decisions.

16.6 Subject to what is said in 16.28 below about maintaining a veto, we recommend that the European Council should normally concentrate on the wider issues. If so, the number of meetings in a given year could be reduced to two, one each in the capitals of the Member States holding the Presidency.

(iii) *The European Parliament*

16.7 The European Parliament was directly elected for the first time in 1979. It has 434 Members, 81 from the United Kingdom.

16.8 The Plenary sessions of the European Parliament are held in Stras-

bourg, while most Committees meet in Brussels and the Secretariat is based in Luxembourg. This geographical separation impedes the work of the Parliament, places unreasonable stress on MEPs, officials and their families and adds significantly to costs.

16.9 The obvious seat for the Parliament is Brussels, where the other main political institutions of the Community, the Council and the Commission, are located. We recommend that Brussels be fixed as the permanent seat of the European Parliament and its Secretariat without delay.

16.10 Under the EEC Treaty the European Parliament has a purely advisory role in the legislative process of the Community. The power of initiating legislation belongs to the Commission and the power of enactment, normally, to the Council. However, the Parliament's influence over legislation has been increasing, especially since its direct election.

16.11 While lacking formal power to introduce legislation, the European Parliament is able, by adopting so-called "own initiative reports", to make its wishes clear to the Commission, and these are frequently acted upon.

16.12 Parliament has taken full advantage of the opportunity offered by the decision of the Court of Justice in the *Isoglucose* case. The case concerned a regulation establishing quotas for isoglucose, a sugar substitute. The regulation had been adopted by the Council without waiting for Parliament to express its opinion formally and was declared void by the Court for that reason.

16.13 The decision appeared to recognise that Parliament has a veto or, at least, a delaying power. To make full use of this power, the procedure for dealing with legislative proposals was changed. Under the new procedure Parliament examines and votes on detailed amendments to proposals but this does not constitute its "opinion", which requires the adoption of a resolution. Before such a resolution is voted on, the Commission may be asked whether it agrees to Parliament's amendments. If it does, the proposal will have to be amended, before being resubmitted to the Council. If the Commission does not agree, Parliament may refer the matter back to Committee for further consideration.

16.14 The procedure has enabled Parliament to strengthen its grip on proposals from the Commission. It has been used with telling effect on a number of occasions, notably in relation to draft legislation on heavy lorries, and to the controversial draft "Vredeling" Directive on employees' rights of consultation and information.

16.15 In the budgetary field the European Parliament acquired important new powers under Treaties of 1970 and 1975. It now has the final say, within a margin of manoeuvre, on items of expenditure classified as "non-compulsory". Compulsory expenditure is, in the words of Article 203 of the EEC Treaty, that "necessarily resulting from the

Treaty or from acts adopted in accordance therewith" (in practice, mainly expenditure on the CAP). Parliament also has power to reject the budget as a whole. It has done this once, in the case of the budget for 1980, to demonstrate dissatisfaction with the proportion of expenditure going to agriculture.

16.16 The European Parliament exercises detailed control over the activities of the Commission whose members attend its debates and are required to answer oral and written questions. That control rests ultimately on Parliament's power under Article 144 of the EEC Treaty to dismiss the Commission *en bloc* on a motion of censure carried by a two thirds majority of the votes cast, representing a majority of MEPs. The power, once regarded as too extreme for use, has become a much more practical weapon in the hands of a Parliament that is directly elected.

16.17 Parliament has for long been anxious to extend its influence over the formation of the Commission. A step towards this was taken in 1980 when it voted on the appointment of the new Commission, in the belief that, if not approved, the Commission would be unable to assume office. The Stuttgart Declaration acknowledged (subject to a Danish reservation) that Parliament has a right to be consulted before the appointment of the President of the Commission. We return to these matters in 16.37 below.

16.18 Another advance for the European Parliament in the Stuttgart Declaration was the recognition of its right to be formally consulted on agreements with non-member countries, including treaties of accession.

16.19 The DTFEU proposes a radical increase in the powers of the European Parliament, especially in the legislative field. Parliament would become part of a bicameral legislature with the Council as the upper chamber. In the event of disagreement between the two chambers, there is provision for conciliation. The Commission would retain its power of initiative, but that power would be extended to the Parliament and the Council.

16.20 In the long term it may be right that Parliament's legislative powers should be increased. The task for Parliament is to convince the electors that it is the natural channel for their demands and aspirations on matters falling within the Community sphere; and to convince the Council and the Commission that they cannot afford politically to ignore its views. At the end of this process, a *de facto* bicameral system could be created by a series of constitutional conventions, without formally amending the Treaties.

#### (iv) The Council

16.21 The Council is composed of Ministers representing the Member States. "General Councils" are attended by Foreign Ministers and the

various specialised Councils (Finance, Transport, Environment etc.) by the holders of the appropriate national portfolios. Preparatory negotiations are carried on by a Committee of Permanent Representatives (COREPER), consisting of the Member States' Ambassadors to the Community and, on more technical matters, their staffs.

16.22 The blockage of proposals in COREPER and the Council is the most serious institutional problem facing the Community. At the present time there are over 500 draft measures, which have been considered by Parliament, awaiting adoption.

16.23 In considering action to help clear the blockage of proposals, a distinction has to be drawn between the *practice* of unanimity followed by the Council in cases where it has power under the Treaties to act by a majority (normally a qualified majority) and the *rule* of unanimity imposed on it by the Treaties in certain cases.

16.24 The EEC Treaty gave the Council power to take decisions by a qualified majority on many matters, including the CAP, from the end of 1965. It was no coincidence that the Community's greatest constitutional crisis occurred at that time. The crisis was precipitated by the refusal of the French Government to deal with the arrangements for financing the CAP as part of a package including "own resources" for the Community and enhanced budgetary powers for the European Parliament. Having failed to unwrap the package, the French Government withdrew its representatives from all Community bodies for six months ("the policy of the empty chair"). The crisis was eventually resolved at an extraordinary meeting of the Council held in Luxembourg during January 1966. The so-called "Luxembourg Accords" included a statement on majority voting. France's five partners took the view that, where "very important interests" of a Member State are involved, the Council should attempt within a reasonable time to reach unanimity but that the possibility of voting should remain as a last resort. Nevertheless, it was the French view, that in such cases the decision must be unanimous, which prevailed in the Council's subsequent practice. Thus a right of veto in relation to a Member State's "very important interests" came to be established, not by law (since the Treaties had not been amended) but by convention. Only in the budgetary field have majority decisions regularly been taken; though in other fields there have been many decisions without unanimity, where dissenting Member States have been willing to abstain.

16.25 The practice of unanimity on declaration of a very important interest was broken for the first time in May 1982 when a decision on agricultural prices was adopted by a qualified majority against a British veto. This was justified by some on the ground that the British interest was indirect - the purpose of the veto was to force agreement on a budget rebate for the United Kingdom. The moral is that the national veto remains alive but there are risks in its purely tactical use.

16.26 The protection afforded by the veto is purchased at a price. One Member State's interest defended may be another's opportunity lost. A way round the dilemma is "packaging". A minister agrees to an item he regards as unsatisfactory, or even positively harmful, in order to win agreement on something else considered beneficial. The trouble is that packages are liable to become extremely complex. This makes for slow progress and a series of unhappy compromises.

16.27 A right of national veto in defence of very important interests reflects current political reality and is likely to continue to do so for the foreseeable future. Yet clearly national blocking power should not be used lightly. The Community must not be stopped from responding rapidly to the challenges it faces.

16.28 Where the Treaties permit majority decisions by the Council, practical steps should be taken to help restrict the use of the veto to the defence of genuinely important interests. We recommend one or more of the following:

(a) A Member State that invokes its veto should be required to put its reasons in writing. This, it has been argued, might lead to greater rigidity. But the risk seems a small one by comparison with the possible advantages.

(b) Agreements should be negotiated on groups of items that will be dealt with by majority vote.

(c) Where the veto has been invoked, the item should be postponed for six months. The case would then have to be supported by the Head of Government personally in the European Council if the veto is to be maintained.

(d) Abstention should be encouraged as an alternative to using the veto.

16.29 Where the Treaties impose a rule of unanimity, we recommend that the Council proceed by way of broad enabling legislation, establishing a framework within which it is provided that more detailed measures may be adopted by a qualified majority.

(v) *The Commission*

16.30 The Commission occupied a central position in the early years of the European Community. Its powers under the ECSC Treaty are more extensive than under the EEC Treaty. The balance between the Commission and the Council shifted in favour of the latter during the 1960s. This was for a variety of reasons: the practice of unanimity on the Council, following the crisis of 1965/66 and the Luxembourg Accords; the development of COREPER as a buffer between the Commission and the Council; encroachment on the Commission's right of initiative by pressure from Parliament and the Council to bring forward particu-

lar proposals for legislation; and the new role of the European Council in mapping out the Community's future.

16.31 Nevertheless, the powers of the Commission remain very great. It still has the major share in the initiation and implementation of legislation. In applying the rules on competition it has a quasi-judicial role. It negotiates with other countries on behalf of the Community. And it remains responsible for ensuring that Member States comply with their obligations under the law of the Community.

16.32 In contrast to most national administrations, the Commission is very open. It is relatively easy to meet members of the Commission's staff and wide soundings are taken when legislation is being drafted. Such openness is praiseworthy; but it may give rise to considerable alarm in interested circles during the long period needed for preparing a proposal. The draft Vredeling Directive is a case in point. We think it desirable that the political influence of the European Parliament should be brought to bear as early as possible in the legislative process. Accordingly, we propose that, before a measure is drafted, the Commission should submit a Green Paper on the subject to the relevant Parliamentary Committee. If the Committee finds the proposal outlined in the Green Paper unacceptable, and it is not withdrawn, a debate should be held on the subject.

16.33 The staffing of the Commission should be reviewed. Some Directorates are over-staffed, others lamentably under-staffed. The problem has not been resolved by the present Commission and appears to be a consequence of union strength, on the one hand, and the rigidity of the Staff Regulations (which apply to all the institutions), on the other. We recommend that the Court of Auditors be invited, in conjunction with outside experts, and in co-operation with the Commission, to investigate and report publicly.

16.34 The effectiveness of the Commission depends on the quality of its members. It is an open secret that in the past some Member States have reappointed Commissioners whose past performance has been lacklustre.

16.35 It is wrong that certain portfolios in the Commission should become the fiefdom of certain countries. We recommend that a portfolio should not be held by a Commissioner from the same country for more than eight years.

16.36 A recent problem has been an excess of members of the Commission over the interesting and challenging jobs that are available; and the entry of Spain and Portugal can only make matters worse. We recommend that the number of Commissioners be reduced to one per Member State. At the same time, we would not wish to diminish the political weight of the Commission. We recommend the establishment of a second layer of authority in the form of assistant Commissioners, rather similar to junior ministers in the British Government. The Presi-

dent of the Commission should be empowered to appoint up to one assistant Commissioner per country.

16.37 At present the Commission lacks cohesion because its members are in practice each appointed by their Governments. In the long term we recommend that they be chosen by the President in consultation with the Member States, and that he should also have the right to dismiss them. He should be free to include members of the European Parliament in his team. To reinforce the responsibility of the Commission to the European Parliament, we recommend that the appointment of Commissioners be subject to confirmation by Parliament and that the President himself be elected by Parliament from a short list agreed by the European Council.

(vi) *The Court of Justice*

16.38 With the passage of years, the Court has steadily increased its reputation and authority. However, its caseload has become very heavy. Cases involving disputes between institutions of the Community and their employees ("staff cases") absorb an unjustifiable proportion of the Court's time. We recommend the immediate establishment of a tribunal of first instance for staff cases, from which an appeal on points of law only should lie to the Court.

(vii) *The Court of Auditors*

16.39 The Court of Auditors has also, since its relatively recent formation, performed effectively. One concern expressed is that its reports are so much franker than those emerging from national administrations that it puts the Community institutions in an unnecessarily bad light. In our view the merits of this uncomfortable exposure will be seen in gradually improving institutional performance. The Court should, however, take care to present a balance in its reports, including, where appropriate, significant comments on effective or improved performance.

(viii) *The Economic and Social Committee (ECOSOC)*

16.40 ECOSOC is, perhaps, the least known institution. It was formed in 1958 to represent the views of employers, trade unions and consumers. It issues reports and since 1972 has had the right to adopt opinions on its own initiative, to publish its opinions and open its doors to the press. In the days of a non-elected Parliament ECOSOC played a significant role in ensuring that the views of interest groups got through to the levels at which decisions are taken in the Community.

16.41 Since 1979, however, it has become increasingly clear that a full time Parliament, particularly one that examines and amends legislation

in detail, is the natural focus for lobbying. In addition, interest groups are able to make their views known to the Commission either through specialised consultative committees or directly, as well as to the national governments. These various possibilities for exerting pressure seem enough.

16.42 We, therefore, recommend that the Economic and Social Committee should be suspended as soon as possible and eventually abolished by Treaty amendment.

## 17. A COMMUNITY OF SOVEREIGN NATIONS

17.1 The architects of the European Community had to devise a structure that would achieve the required measure of unity without diluting the absolute value of the unique, the historical and the multifarious in Europe.

17.2 The Community to which we look forward in the early years of the next century will be, like that of today, a political order without precedent. That makes it hard to characterise. It will be something much more than an international organisation yet much less than a state.

17.3 An issue which still exercises critics of the Community in Britain is that of sovereignty. Two points about sovereignty need to be clearly grasped. The first is that sovereignty should be thought of not as a single enormous right but as a bundle of rights, which may be distributed among different authorities. The second thing is that formal sovereignty is not at all the same as practical power. The world today is full of states enjoying the dignity of sovereignty but lacking any control over their destinies.

17.4 The Member States of the Community believe, correctly, that by pooling certain of their sovereign rights, they stand a better chance of achieving their aims both at home and in the international arena. Freedom to act unilaterally is curtailed, in order to widen the area of effective choice. Since the pooling of rights is partial, and its result to enhance sovereignty, the phrase "a Community of sovereign nations" seems apposite.

17.5 A Community of this kind poses no threat to national identities. Polyglot, heterogeneous, decentralised, it has only one orthodoxy - that of political and economic liberty.

## 18. SUMMARY OF RECOMMENDATIONS

### Non-tariff barriers

#### *Short-term*

- (1) The harmonisation of technical standards should be completed within five years. Where possible, the most acceptable national standard should be used.
- (2) National and European standards bodies should receive more resources and cooperation between them should be fostered.
- (3) Each Member State should designate in each of the other Member States testing laboratories whose findings it undertakes to recognise.
- (4) Member States that refuse to remove illegal barriers when ordered to do so by the Court of Justice should be liable to forfeit payments due from the Community. The Commission and Member States should be able to obtain injunctions from the Court against flagrant abuses of standards within days.
- (5) Individual traders should be encouraged to bring cases before national courts under common procedures to challenge illegal barriers under the *Cassis de Dijon* principle.
- (6) The opening hours of customs posts should be synchronised and the single customs document should be further simplified.
- (7) Bilateral quotas for road transport should be ended as soon as possible.
- (8) The Draft Fourteenth Directive on VAT should be withdrawn and replaced by a Deferred Payment System.
- (9) Firms should be encouraged to apply for public contracts in other Member States. The Commission should prosecute all detectable cases of discrimination. Where projects are co-financed by the Community, strict observance of the Directives on public procurement must be ensured.

#### *Long-term*

- (1) Testing and certification of goods should be carried out by a Community inspectorate responsible to the Commission.
- (2) National customs services should be replaced by a Community-controlled service.

(3) Any Community transport policy which may emerge should provide for the free movement of road transport. In certain rural areas heavy lorries may have to be confined to motorways, trunk and major roads.

(4) Harmonisation of rates of VAT within "bands" should be considered.

(5) A clearing system between the VAT authorities of Member States should, with the help of computers, avoid the break in collection which occurs on exportation.

### Services

#### *Short-term*

- (1) The programme of legislation to facilitate the transnational provision of professional services should be completed without delay.
- (2) Harmonisation of legislation on banking to facilitate transnational banking services should be completed within five years.
- (3) The Commission should investigate public service monopolies to discover whether their exclusive rights are necessary and what effect they have on trade between the Member States.
- (4) The common market in insurance should be completed by harmonisation, where restrictions result from justified safeguards; and by legal action, taken in national courts by insurers and brokers, or in the Court of Justice by Member States and the Commission, where justification is lacking.

#### *Long-term*

- (1) The airspace of the Community should be unified by treating all flights between Member States as domestic; and by issuing licences to operate routes to Community carriers irrespective of nationality.

### Competition

#### *Short-term*

- (1) A Community system of merger control should be established by a regulation of the Council.
- (2) A Board of Assessors should be set up to advise the Commission on the application of the rules of competition. It should be serviced by a

new Directorate within DGIV. The members of the Board should be part-time.

(3) Agreements notified for the purpose of obtaining exemption under Article 85 (3) of the EEC Treaty should be deemed to be valid throughout the period between notification to the Commission and the latter's decision.

(4) The Commission should be given a time limit (say 90 days), after which, if no decision had been reached, a notified agreement would automatically receive exemption for three years.

(5) The staff of Directorate B of DGIV should be substantially increased, at the expense of other Directorates-General that are less necessary to the functioning of the common market.

### Monetary Policy

#### Short-term

(1) The coherence of the mechanism of the European Monetary System, particularly in relation to the US Dollar, should be increased. Important steps in this direction would be: the targeting of "zones of probability" of exchange rates between the European Currency Unit (ECU) and the Dollar or Yen; and making the ECU freely convertible.

(2) The Central Banks of certain third countries should be authorised to acquire and hold ECUs.

(3) Private use of the ECU should be encouraged, whether or not Britain joins the Exchange Rate Mechanism.

(4) Institutional co-ordination and the convergence of economic - especially monetary - policies within the Community should be pursued. The exchange of information and the removal of restrictions on capital movements in ECUs would assist this.

(5) A European Monetary Fund should be established, enjoying an initial endowment of reserves and considerable independence. The aim would be to create a zone of monetary stability.

(6) The arguments against Sterling's inclusion in the ERM on the grounds that Sterling is subject to unpredictable pressures from capital flows and that it is a "petro-currency" are unconvincing. Sterling should join the ERM as soon as practicable. Objections to fixing a target for Sterling's exchange rate could perhaps be met by the use of a wider band of 6%.

#### Long-term

(1) The goal of a European Monetary Union should be pursued, particularly by Britain. National currencies could, however, continue to play a part alongside the ECU.

### Industrial Policy

(1) Interventions, whether by Member States or the Community, should not impede the common market or the control of inflation and public expenditure.

(2) A standard company form should be introduced throughout the Community.

(3) The Community should support research and development of new industrial technology, as in the ESPRIT programme.

(4) The Community should offer "soft" loans to small businesses, but only through private institutions applying commercial criteria.

(5) The Commission should be stricter in enforcing the EEC Treaty's intention that state aids should not distort the common market by preserving ailing industries.

(6) The Commission should insist on advance notification of new state aids, as it is entitled to do.

(7) The Commission should be empowered to authorise the imposition, in appropriate cases, of countervailing import duties on goods produced with illegal state aid.

### Energy Policy

(1) An energy tax on fuel consumption of around 1% to finance the Community's energy policy should be considered; but the arguments in favour of it seem, on balance, to be insufficient.

(2) The sharing of information and cooperation in general between governments and the energy industries of the Community should be improved.

(3) Investment at Community level in future fuel technologies (HEP and geothermal; oil and gas produced by liquefaction and gasification; nuclear energy) should be seriously considered.

## Common Agricultural Policy

### *Short-term*

- (1) A deficiency payments system for Mediterranean products not hitherto subject to price support may have to be developed after the accession of Spain and Portugal, in order to avoid new surpluses.
- (2) Guidelines for price decisions in the Council of Agricultural Ministers should be laid down with the participation of Finance Ministers.
- (3) Annual price-fixing should be replaced by multi-annual decisions in accordance with the rest of the Community's Budget.
- (4) Explicit recognition should be given to the non-agricultural functions of the CAP, and co-ordination with other Community funds should be improved.
- (5) Indiscriminate disposal of surpluses in third countries should be avoided.
- (6) Every effort of farmers to maintain their incomes by reducing input costs rather than increasing output should be encouraged.

### *Long term*

- (1) Surplus food production should be brought under control.
- (2) The internal contradictions between the aims of the CAP should be resolved by matching financial commitments to resources.
- (3) Monetary Compensatory Accounts should be removed, since they distort the agricultural market.
- (4) Production incentives should take account of public concern about the environment.
- (5) Protectionist tendencies concerning food imports should be kept in check.
- (6) The CAP should develop in such a way that the interests of producers, consumers, agricultural workers and taxpayers are balanced.

## The Community's Finances

- 1 Contributions to the resources of the Community should be related to the ability to pay, and any major reform of the budgetary mechanism

should be implemented on the revenue rather than the expenditure side.

2 The Community must be seen to exercise the tightest possible control over its expenditure if Member States, which are mostly trying to balance their budgets, are to concede it additional resources.

3 On these conditions, the decision of the European Council in March 1984 to remedy the shortfall in the Community's "own resources" by raising the ceiling on VAT from 1% in two stages to 1.6% should be supported.

## European Political Cooperation and Defence

### *Short-term*

(1) The present staff of the Presidency should be extended to include seconded individuals from the Foreign Ministries of all Member States, though the preceding, incumbent and succeeding holders of the Presidency should continue to provide most of the staff (the "Troika" system).

(2) Member States working within European Political Cooperation (EPC) should try to anticipate points of difference with the United States and to agree on a constructive joint position.

(3) The Community should take more responsibility than hitherto for pursuing peace in the Middle East, using the machinery of EPC to achieve a common policy in this strategically vital area.

(4) Conventional defences in the Community should be strengthened.

### *Long-term*

(1) The Community should work towards a common foreign policy based upon consensus and outside the EEC Treaty, as at present.

(2) The Community should play a larger part in the development of defence technology, in order to offset the cost of improving conventional forces by promoting the division of labour with the United States.

## Development Policy

### *Short-term*

(1) The Community's Generalised System of Preference should be further liberalised and the protectionist legacy of the recession dismantled.

(2) The STABEX system should not be allowed to render countries dependent, nor to produce structural surpluses.

(3) The Community should give greater attention to the evaluation of the impact of its aid on the economies of recipients.

(4) Training and education for developing countries should be given a high priority.

(5) "Policy dialogue" between the Community and countries in receipt of its aid should be extended to cover relevant internal policies of the Community; and other donors in each country should be involved in the dialogue.

(6) The Community should assist population programmes, so long as religious scruples and human rights are respected.

(7) An independent committee should be appointed by the European Council to review the Community's development policy.

#### *Long-term*

(1) Priority must be given to providing the means for developing countries to feed themselves. Except in emergencies, food aid should only be given to those countries which are prepared to adjust their internal policies sufficiently to avoid dependence.

(2) If and when the Community's food surpluses are brought under control, resources should be switched from food aid into agricultural projects to a much greater degree than at present.

(3) Private investment must be encouraged to supplement and to reduce the need for official development assistance.

### **The Community's Institutions**

#### *Short-term*

(1) The European Council should not normally be called upon to resolve complex disputes that are causing difficulties in the Council but should concentrate on the wider issues. The number of meetings in a year should be reduced to two.

(2) Brussels should be fixed as the permanent seat of the European Parliament and its secretariat.

(3) A right of national veto on the Council in defence of very important interests is likely to remain necessary. Practical steps to ensure that the veto in the Council is not used lightly might include:

(a) a requirement that reasons be given in writing;

(b) negotiation of agreements on groups of items that will be dealt with by majority vote;

(c) a procedure under which, following a veto, the item in question would be postponed for six months; thereafter, in order to maintain the veto, the case would have to be supported by the Head of Government personally in the European Council;

(d) encouragement of abstention as an alternative to using the veto.

(4) Before legislation is drafted, the Commission should submit a Green Paper on the subject to the relevant Committee of the European Parliament. If the Committee finds the proposal unacceptable, and it is not withdrawn, a debate should be held on the subject.

(5) The Court of Auditors should be invited, in conjunction with outside experts, and in cooperation with the Commission, to investigate levels of staffing in the Commission and report publicly.

(6) A portfolio should not be held by a Commissioner from the same country for more than eight years.

(7) The number of Commissioners should be reduced to one per Member State. The President of the Commission should be empowered to appoint up to one assistant Commissioner per country.

(8) A tribunal of first instance should be established for staff cases, with a right of appeal to the Court of Justice on points of law only.

(9) The Economic and Social Committee should be suspended as soon as possible and eventually abolished by Treaty amendment.

#### *Long-term*

(1) The President of the Commission should choose the Commissioners in consultation with the Member States and should have the right to dismiss them. He should be free to include members of the European Parliament in his team.

(2) The appointment of Commissioners should be subject to confirmation by the European Parliament.

(3) The President of the Commission should be elected by the European Parliament from a short list agreed by the European Council.