

ECONOMIC PAPERS

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No. 83

Août 1990

Completion of the internal market :
An application of Public Choice Theory

by Manfred Teutemann

Internal paper



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1. INTRODUCTION	1
2. THE THEORY OF PUBLIC CHOICE	2
2.1. THE ACTORS' BEHAVIOUR	2
2.2. INTERFERENCES IN THE DECISION-MAKING PROCESS	4
2.3. ORGANIZATIONAL PROBLEMS OF INTEREST GROUPS	6
3. CHARACTERIZATION OF 1992 IN TERMS OF PUBLIC CHOICE	8
3.1. THE STATUS QUO	9
3.2. CHANGES IN INSTITUTIONS AND RULES	11
3.3. CHANGES IN THE ACTORS' SITUATION	13
3.2.1. The Politicians	16
3.2.2. The Bureaucrats	18
3.2.3. The interest groups	19
3.2.4. The voters	22
3.2.5. The media	23
3.4. SUMMARY	24
4. LIKELY OUTCOME OF THE INTERNAL MARKET PROGRAMME	25
4.1. THE CONTAINMENT OF THE RISE OF THE PUBLIC SECTOR	25
4.2. THE INFLUENCE OF INTEREST GROUPS AND "FORTRESS EUROPE"	27
4.2.1. Minimum standards and national rent-seeking activities	27
4.2.2. Protection against intra-EC competitors	28
4.2.3. Protection against extra-EC competitors -- Fortress Europe	29
4.3. SOME EVIDENCE	32
4.4. SUMMARY	34
5. REDUCING THE RISKS OF INEFFICIENCIES	35
5.1. THE NEGATIVE IMPACT OF INTEREST GROUPS	35
5.2. THE INCENTIVES OF POLITICIANS AND BUREAUCRATS	40
5.3. THE ILL-INFORMED AND UNINTERESTED VOTER	42
6. CONCLUDING REMARKS	44
References	46

1. INTRODUCTION

Completion of the internal market in 1993 will be accompanied by strong hopes of faster growth, enhanced competition, reduced costs and increased wealth, as predicted in the CECCHINI-report (1988). A more pessimistic view, however, is that the creation of the internal market may indeed lead to the intended strengthening of market forces, but will also lead to greater monopolization of markets and protectionism - thereby implying net welfare losses. The result of the internal market programme will be intensified national and international collusion reducing the level of competition. At the same time, protective regulations and constraints in property rights, which were justified to internalize externalities and alleviate the negative effects of market failures, will be weakened. This paper considers these conflicting viewpoints in the context of public choice theory and presents a series of recommendations to reduce the potentially negative impacts of individual egoism and rent-seeking¹ after completion of the internal market.

BERNHOLZ has already pointed to the more negative aspects of 1992. He pronounced that "an erosion of the advantages gained by removing national borders has to be expected" because of the detrimental effect of interest group activities in market-oriented democracies (and by implication in a European Community without national borders), (BERNHOLZ 1989, p.1, p.38). While he concentrated on the growth of the public sector, the increasing influence of pressure groups and the negative impact of both of these phenomena on technical progress, this paper focusses on the application of public choice theory to the process of European Integration in general and the creation of the internal market in particular. That the growth of the

¹ Economic agents have two basically different possibilities to influence their profits: either by selling (more) on the market and by optimizing their production function or by influencing the legal and institutional frame under which they are operating on the market, e.g. by cartelization or by looking for subsidies, tax reductions or protection against potential competitors. The latter activities are called "rent-seeking activities". They become the more prominent the more a government is prepared to intervene into markets and the less dynamic respective markets perform. For some literature on this see BUCHANAN, TOLLISON & TULLOCK (eds. 1980): Towards a Theory of the Rent-Seeking Society.

public sector and the increased influence of pressure groups tends to impact negatively on growth and productivity, is taken as given.²

The two important questions to be addressed in this context are : (a) if neither the growth of the public sector nor the increasing influence of interest groups can be reduced, are there other means by which their negative impact might be alleviated ? (b) Who will be the winners and losers after 1992 in terms of public choice and rent-seeking ? In replying to these questions, the paper relies heavily on the analysis presented in the CECCHINI-report and BERNHOLZ's paper.

2. THE THEORY OF PUBLIC CHOICE

The theory of public choice and other related theories attempt to apply the tools of general economic theory to the political decision-making process. By analysing the goals and incentives of different individual actors and groups and the problems posed in organising groups, these theories give new and worthwhile insights into the workings and outcome of the political process.³

2.1. THE ACTORS' BEHAVIOUR

The outcome of interaction between politicians, bureaucrats, pressure groups and voters, is often economically inefficient and welfare reducing. This is the case even though all of those actors behave rationally vis-à-vis their own short-term utility function. In explaining such a disappointing outcome,

² The negative impact of a growing public sector on economic output is largely a statistical and measurement problem due to the fact that no markets exist for public goods and output from this sector is measured by its input. But if output equals input there will be, by definition, no productivity progress and an economy which comprises only the public sector can not grow unless it increases public employment. Therefore, comparison of the (statistical) growth performance of countries with significantly different public sector/GDP ratios presents difficulties.

³ Some key literature of public choice theory is: BUCHANAN (1975): The Limits of Liberty; BUCHANAN & TULLOCK (1962): The Calculus of Consent; DOWNS (1957): Economic Theory of Democracy; NISKANEN (1971): Bureaucracy and Representative Government; OLSON (1965): The Logic of Collective Action; OLSON (1982): The Rise and Decline of Nations; WILLIAMSON (1982): The Economic Institutions of Capitalism.

we must begin by addressing a number of questions : What are the goals of these groups of actors ? Why do they act as they do and what are the driving forces behind them? Public choice theory gives some answers to these questions. These answers can be described here briefly (and admittedly a little bit simplistically) as follows :

The groups of politicians, bureaucrats, pressure groups and voters are naturally composed of individual actors. Each individual actor aims to increase his own benefit without necessarily having regard to the benefit of the other members of the group he represents. Of course, his individual actions must also have positive effects on the welfare of his group members'. Thus, politicians want to increase and keep their power and responsibilities (if they are in power) or they want to get into power (if they do not have it). It is not their final goal to fulfil the wishes of the party members or voters. Yet, a necessary condition for politicians to reach their own goals is their success in elections. since voters are rationally uninformed this does not imply that their wishes are always taken into account.

The bureaucrats are struggling for more power and more competences, i.e. a higher budget, a bigger department, without assuming additional responsibility. It is not their final goal to faithfully implement legislation, but it is a necessary condition. However, since laws are necessarily vague, bureaucrats can interpret them in their own interest, so that they are not forced to implement legislation quite faithfully.

Representatives of interest groups are also struggling for additional power and influence, both of which are correlated to the size and strength of the particular interest group. Again, it is a necessary side effect that they increase the benefit of the members of the group they represent by influencing politicians and other decision makers.

Voters are interested in maximising their benefit from the political process and public services provided. That they control public activity by voting is only a side effect, not the final goal.

Finally, editors as entrepreneurs in the media fight for higher profits through higher circulation and higher revenues from advertisements. Meanwhile, journalists and editorial staff are interested in a higher wage bill. Besides these final goals they also want to have influence on the society in which they live. So, the media not only make profits but also spread information and serve as the fourth power along with the legislative, judicial and executive power. However, this side effect is welcomed by at least some sections of society.

2.2. INTERFERENCES IN THE DECISION-MAKING PROCESS

What impact do the different goals and attitudes of the participants in the political decision-making process have on the provision of public services? The politicians will try to avoid any major conflict with representatives of those groups which are influential and powerful and thus important to their (re)election. They will try to gain the support of such groups, e.g. by giving them subsidies which have to be financed by other less influential groups. If burdens have to be distributed, politicians will try to burden groups by imperceptible means (struggle for intransparency), e.g. by existing tax progression, levying of indirect taxes etc. They will particularly avoid implementing or even supporting a transparent equivalence financing system, e.g. in the form of contributions or duties. The existing budgetary system and the shaping of the institutional legislative process normally facilitates such efforts to avoid transparency. The outcome is a very complicated tax and subsidization system with many loop-holes known only to specialized insiders.

Bureaucrats are anxious to retain as much autonomy as possible by submitting only a minimum of information to the decision-maker; in this way they retain a very important information advantage. Furthermore, the information submitted to the decision-maker is biased in favour of the bureaucrats. This means that projects which the administration support are presented in a very favourable light while less supported projects will not receive favourable treatment. In addition, the administration will try to

reduce its input, (as long as this does not result in a smaller budget) by relying as far as possible on external expert advice. The preferred outcome in the eyes of bureaucrats and pressure groups will be that the external experts provide advice which pleads in favour of higher public budgets or new administration units. This was the case for the nuclear industry, for example. In a choice between the implementation of a simple and transparent procedure or a more complicated and less transparent procedure, the bureaucrats will opt for the latter. On the one hand, more complicated procedures are normally connected with a higher need for resources, implying a higher budget and more staff. On the other hand, a more complicated procedure reduces the degree of transparency and thus heightens the dependence of third parties on the administration.

The representatives of interest groups try to manipulate the decisions of politicians and the administration to their own advantage. This is achieved partly by the distribution of biased information, which, however, may be considered by the administration and politicians as an essential element of day-to-day business. Decisions may also be influenced by implicit or explicit threats. The threat of influencing voters' attitudes and voting behaviour may be quite successful against politicians. The administration may react to threats to make daily business more difficult or threats to apply pressure through the hierarchy. The farmers' pressure groups serve as an example of this kind of behaviour. There are no common rules with the exception of the prohibition of active and passive bribery.

The individual voter is badly informed. Observing the interplay between politicians, administration and pressure groups, he is confident of his own marginal influence on both the decision-making process and the result of elections. Assuming rational behaviour on the part of the individual voter there must be a reason why in the market process the individual consumer normally invests substantial time and resources in seeking information while in the political process the individual voter seems uninterested in acquiring information. The answer is to be found in the context of absolute and relative information costs :

- (1) Normally the bureaucracy and the politicians prefer not to release information to the outside and especially not to the voter; this would facilitate greater control on their activities. Thus, it is made quite difficult for the voter to acquire the necessary information.
- (2) If the individual voter finally acquires the information necessary for a well-informed voting decision how will he use it? He cannot influence political decision-making at all. Consequently, there will be an inadequate yield from the acquired information. Therefore, it makes no sense for the voter to waste resources in collecting information. He is rationally ill-informed, or, as OLSON says with reference to DOWNS: he is "usually rationally ignorant about public affairs" [OLSON 1982, p. 26].

So far, it seems that only the media focus a steady flow of information on the voter. The media provide this information in combination with another private good - entertainment. They have their own role in the interplay of actors in the political decision-making process. The representatives of the media are interested in good relations with important sources of sensitive information in the political, administrative and business spheres. Depending on the ideological stance of the editor and researcher, the media will try to influence the behaviour of voters, mainly through incomplete and biased information, however, subject to the restriction that profits are not reduced by publishing information. As voters react to information from the media politicians, bureaucrats and enterprises have to be interested in good relations with the media. In consequence, the media can be said to partly control the Government and the administration, at least as regards some fields of policy making.

2.3. ORGANIZATIONAL PROBLEMS OF INTEREST GROUPS

In his book "The Choice of Collective Action" OLSON (1965) analysed the problems relatively to the organisation of interest groups, who provide a public or collective good. OLSON lists four main reasons, which will make the provision of public and collective goods quite difficult on a private basis, if it is necessary to provide them with the help of a group.

- (1) free-rider problem: An important characteristic of public goods is, that once they are provided they are publicly available and cannot be directed exclusively to those who paid for them. The resulting free-rider problem often has enormous consequences for organizing groups. Influence on the public decision-making process is an example of such a public or collective good. Modifications of laws and the institutional framework never apply to a single case but are compulsory for all. The modified framework applies also to those who were not participants in the relevant pressure groups and who were not paying contributions.

- (2) minimum size : the larger the group required to provide a good successfully the more unlikely it is that there will be a positive outcome. This is because organization and negotiation costs rise progressively with the number of group members involved. A group of entrepreneurs, representing ten enterprises, may have a significant influence on the economic policy of a country. Similarly a consumer group, representing 100 000 consumers could influence the politics of consumer protection. However, it is clearly more difficult to organize such a large group of consumers than it is to organize a group of 10 entrepreneurs. The question in this context may be : what are the reasons why it is sometimes sufficient to be a member of a small group and sometimes it is not. This question will be touched in chapter 6 of this paper.

- (3) Low-benefit problem : The lower a potential member rates the potential benefit to himself from any given organised action, the less likely it becomes that he will be attracted as a paying member of a corresponding pressure group. Therefore, we are more likely to find a pressure group which focuses on the interests of tenants, car owners or steel producers than one which focusses on the interests of cyclists. The reason is that for the first group the relevant products count relatively highly in their total income use or origin. That is one reason why procedures are better organized in certain fields of policy than in others.

(4) Selective incentives : If it is not possible to give additional selective incentives accompanying the provision of a public or collective good, it becomes less likely that the public good will be supplied at all. These selective incentives are necessary to evade the free-rider problem. They are normally private goods where an exclusion of non-contributing users can be effectively guaranteed. So it is possible to exclude non-members of trade unions from the benefits of union-run strike funds; benefits out of this fund are for members only. Political parties are another example; in addition to political influence they can offer jobs in the government and/or in the parliament exclusively to paying members of the party.

The minimum-size and selective-incentive criteria are mainly responsible for the relative unimportance of tax payers, consumers, environmental protection groups, etc.. They remain, as OLSON calls them, latent groups. To achieve their goals, these groups require high membership, but are unable to exclude non-members from the results of their pressure.

If we consider (1) the goals of the actors sketched above, (2) the incentive structure, (3) the fact that recent institutional realities support both and (4) the asymmetry in organizing interest groups, also sketched above, some outcomes of the political decision-making process can be easily explained. Therefore, public choice theory can be seen to explain many important developments, commonly discussed under the heading of government failure.

3. CHARACTERIZATION OF 1992 IN TERMS OF PUBLIC CHOICE

The adoption of the internal market programme and of the Single Act derived from the hope that European integration will now progress more successfully, leading to increased welfare for all and not just for minorities. The hope is that there will be a significant and positive impact on the economy and labour market, that competition will be enhanced, prices will be reduced and the negative impact of pressure groups and of the public sector on European welfare will be alleviated.⁴ But what will be changed by the internal market

⁴ For details see the CECCHINI-report and the BERNHOLZ-paper.

programme and the Single Act ? What impact will both programmes have on the situation and the behaviour of the different groups of actors (politicians, bureaucrats, interest groups, voters and media) ? These questions are addressed in the following sections. Public choice theory will be employed to seek worthwhile explanations for the actual evolution of European integration. In this respect, it is helpful to look firstly at the actors, their institutional surroundings and the institutions they have created for themselves.

3.1. THE STATUS QUO

The relevant actors, in the public choice context, during the 30 years of European Integration were mainly politicians, bureaucrats, producer lobbies and unions on the national level, while the only important group on the European level was the bureaucrats in the secretary of the Council and in the Commission. In other words, those who expected high benefits from interaction (high benefits in both, terms of absolute benefit and in relation to total individual benefit) were playing an important role, while those bearing the greater burden i.e. consumers (who had to pay higher food prices) or tax payers (who had to pay higher taxes) were not represented as they did not realize the connection between European policy and, e.g. higher food prices and higher taxes. They had no significant influence on the integration process or were not sufficiently organized or interested (low-benefit problem).⁵

Moreover, because European integration rapidly became a technical process, invisible to the public (like the abolition of tariffs within the EC), it received little attention from the media. Even when there were entertaining messages to be sold to the public (mostly negative ones linked to milk lakes, butter mountains or the resources spent on defining the difference between male and female trousers), the lack of transparency in the distribution of responsibilities ensured that the blame was unjustly placed

⁵ Assuming that European policy is a transparent policy, e.g. that the Common Agricultural Policy is designed in a way that instead of market interventions every farmer would get a monthly DM 1000, financed out of tax revenues, tax payers and other social groups would fight for their interests.

on the European institutions ("the bureaucrats in Brussels") and not on the national ministers, supporting rent-seeking activities of farmers and other powerful interest groups.

In considering the institutions created, it is noteworthy that the main difference between the national and European level is that the European Parliament and the individual voter are less powerful than its national counterparts. This has made the European Parliament comparable to the Opposition at the national level. Its goals and incentives can be described as those of national politicians not in power; the final goal of the European Parliament may only be to achieve a greater role and to finally obtain power despite recent institutional obstacles. The absence of control on the real European Government (Council and Commission) as implied by the institutional structure of the European Communities is a further element contributing to an inefficient outcome of the political decision-making process. Public choice theory applied to this institutional framework would predict that the political decision-making process at the European level is less efficient and more biased in favour of minority interests than decision-making at the national level. The main reasons for this prediction are : (1) The smaller possibilities of voters disturbing the interplay of politicians, bureaucrats and pressure groups, due to the institutionalized impotence of the European Parliament. (2) The lower level of interest among voters in collecting information on what is happening in Europe and finally, (3) the media's lack of interest in publishing relevant information to the general public, due to the technical nature of this information and the lack of transparency in policy-making at the European level.

As already mentioned, public choice theory implies an asymmetry in the formation of interest groups so that latent groups like consumers and tax payers are normally not organized or have only a marginal influence on the political decision-making process. This implication, however, is not only valid for the national and subnational level but especially for the supranational level.

The asymmetry at the national level has had very important implications for the design of the institutionalised decision-making process at the European level. The national asymmetry was in fact directly institutionalised in the composition of deciding or advising organs at the European level. The composition of the Economic and Social Committee (ESC) is described as follows (Art. 193 EEC Treaty) : "The Committee shall consist of representatives of the various categories of economic and social activity, in particular, representatives of producers, farmers, carriers, workers, dealers, craftsmen, professional occupations and representatives of the general public". No specific reference is made to tax payers, consumers, or environmentalist groups. They are all subsumed under the term "general public". However, at least 8 out of the 10 mentioned groups can be subsumed under the term "producer and similar interests".

This explicit description of the composition of the ESC is reflected in the daily business of European integration, for example the Common Customs Tariff, the so-called anti-dumping procedures and self-constraining treaties, the common agricultural and transport policies. Producer interests are represented at every stage of the decision-making process while interests such as consumers are not.

3.2. CHANGES IN INSTITUTIONS AND RULES

The internal market programme aims at the abolition of welfare-reducing regulations relating to crossborder migration, as well as goods, services and capital movements. The consequences of abolishing these regulations should not be underestimated :

- The abolition of physical controls on goods and persons at the internal borders, accompanied by the new system of EC-wide mutual recognition will marginalise crossborder checks on goods and services in the medium term. This will not only mean that international labour share and crossborder flows will become even more important, but will also have implications for national rent-seeking activities as discussed below.

- Abolition of discriminatory measures against foreign goods and services even in exemption fields (e.g. public procurement, professional occupations) may change the competition structure and production costs in affected sectors. These changes will also present a new challenge for bureaucrats.

- The international freedom of establishment if it materializes may lead to increased competition and cost reduction in sheltered sectors. Liberalisation of capital markets and international financial services may have a similar effect. Here, too, the principle of "mutual recognition" will give more weight to national rules and minimum requirements.

- The liberalisation of capital movements will allow capital to match those investments in the Community which yield the highest rate of return. In this way, efficiency could be improved; the implementation of the white paper's measures to improve crossborder industrial co-operation could help in this context.

- Harmonization of indirect taxes will allow enterprises of different countries to compete against each other without excessive distortions arising from different tax rates.

The Single European Act, too, includes some details which affect the institutional structure of crossborder co-operation within the EC. Among these are :

- social policy, environmental policy and research policy are now more prominently located in the hierarchy of Community responsibilities;

- foreign policy has now been formally elevated to the European level, although it is not mentioned explicitly in the treaties;

- the distribution of responsibilities between Council, Commission and Parliament has gradually changed in favour of the latter; furthermore, the

threat of a veto in Council meetings has been reduced by extending the application of majority decision-making.

Yet, several policy fields remain, where the European crossborder co-operation and integration has made little or no progress although economic theory (fiscal federalism, collective goods theory) estimates potential welfare gains⁶ : in the allocation policy field, e.g. defence matters are excluded; the same can be said of distribution and stabilisation policy as a whole, although the "Report on economic and monetary union in the European Community" of 1989 may give additional impulses in these fields.

3.3. CHANGES IN THE ACTORS' SITUATION

The CECCHINI-report expects a reduction of production costs due to economies of scale, a strengthening of competition and a containment of the public sector. BERNHOLZ interprets the internal market programme as a "breakup of an undisturbed development" as defined by OLSON with the chance to roll back the negative influence of interest groups and the public sector on economic performance.

The empirical evidence provided by OLSON in "The rise and decline of nations" (1982) in support of this statement, is quite weak. OLSON says that "it is remarkable how rapidly all six initial members of the European Economic Community have grown" during the 1960s. Then he presents a table (see table 1) which shall reveal "that in general they have grown more rapidly than Australia, New Zealand, the United Kingdom, and the United States ... In some of these initial Common market countries growth was more rapid in the 1960s, when the Common Market took effect, than in the 1950s" [OLSON 1982, p. 5].

Yet, already OLSON himself relativates the empirical evidence of his own statement that the Six enjoyed rapid growth, as -- according to OLSON-- only "some", i.e. Belgium, France and Italy, and not "all" six initial

⁶ For respective studies see e.g. COMMISSION OF THE EUROPEAN COMMUNITIES (1977) and TEUTEMANN (1988).

member countries experienced more rapid growth over the 1960s than over the 1950s. Furthermore, a second glance at table 1 proves that growth of some

Table 1. Average Annual Rates of Growth of Per Capita Gross Domestic Product at Constant Prices (in percent)

Country	1950-1960	1960-1970	1970-1978
Australia	2.0 ^a	3.7 ^b	2.4 ^c
Austria	5.7	3.9	3.8
Belgium	2.0 ^d	4.1	3.1
Canada	1.2	3.7	3.1
Denmark	2.5	3.9	2.2
Finland	3.3	4.2	2.5
France	3.5	4.6	3.0
Germany, Fed. Rep. of	6.6	3.5	2.4
Ireland	1.8	3.8	2.3 ^e
Italy	4.9 ^f	4.6	2.1 ^g
Japan	6.8 ^h	9.4	3.8
Netherlands	3.3	4.1	2.3
New Zealand	1.7 ⁱ	2.2 ^j	— ^k
Norway	2.7	4.0	3.9
Sweden	2.9	3.6	1.2
Switzerland	2.9	2.8	-0.1
United Kingdom	2.3	2.3	2.0
United States	1.2	3.0	2.0

NOTE: Data are from *Yearbook(s) of National Account Statistics* for 1969 and 1978, Statistical Office of the United Nations, New York, published in 1970 and 1979, respectively.

a. 1952-1960; b. 1963-1970; c. 1970-1976; d. 1953-1960;
 e. 1970-1977; f. 1951-1960; g. 1970-1977; h. 1952-1960;
 i. 1954-1960; j. 1960-1968; k. The statistics for New Zealand in this period are not separated from those for "Oceania."

Source: OLSON 1982, p 6.

other OECD countries, e.g. the Scandinavian countries or Japan performed as well or even better than the economy of the Six.

As table 2 shows, there was neither a significant boost to growth in the member countries compared to other industrialized OECD countries nor was the economic performance of the joining countries, Denmark, the UK or Ireland boosted after becoming members of the Communities.⁷

⁷ However, the case of Ireland seems to give empirical evidence to OLSON's hypothesis: The above average growth performance in Ireland in the period immediately after accession may be partly explained by improved access to Community markets and supporting Community transfers. However, the major determinant will have been an expansionary fiscal policy (sometimes procyclical) particularly in the period 1975 - 81.

6/6/1990

GROSS DOMESTIC PRODUCT AT CONSTANT MARKET PRICES PER HEAD OF POPULATION

USD

	EUR6 (1)		DK	IRL	UK	EUR6	EUR9	(2)	
	1960 = 100		1972 = 100						
1960	100.0	100.0	65.1	64.3	76.6	62.7	65.8	64.5	
1961	104.4	102.8	68.8	67.8	78.5	65.5	68.4	66.3	
1962	109.0	107.0	72.1	69.7	78.6	68.4	70.6	69.2	
1963	112.3	111.0	72.0	72.5	81.0	70.5	72.7	71.8	
1964	117.8	116.9	78.1	74.9	84.9	73.9	76.3	75.7	
1965	122.1	121.9	81.0	76.0	86.4	76.6	78.8	79.1	
1966	126.2	127.2	82.5	76.5	87.6	79.1	81.0	82.8	
1967	129.7	130.4	84.6	80.5	89.0	81.3	83.0	84.9	
1968	135.9	136.2	87.5	86.7	92.2	85.2	86.8	88.7	
1969	146.1	141.2	92.6	91.4	93.7	90.4	91.2	92.1	
1970	150.8	143.1	93.7	93.0	95.6	94.6	94.8	93.3	
1971	154.4	146.7	95.5	95.4	96.9	96.9	96.9	95.6	
1972	159.4	153.3	100.0	100.0	100.0	100.0	100.0	100.0	
1973	167.1	160.4	103.0	103.1	106.9	104.8	105.2	104.5	
1974	170.8	158.6	101.6	105.7	105.1	107.1	106.6	103.3	
1975	168.1	157.0	100.6	109.8	104.3	105.4	105.1	102.2	
1976	176.7	162.7	106.9	109.6	107.2	110.8	110.0	105.9	
1977	181.5	167.8	108.3	117.0	109.7	113.9	112.9	109.3	
1978	186.8	174.2	109.5	123.8	113.7	117.2	116.3	113.4	
1979	193.9	177.5	113.1	125.6	116.8	121.6	120.4	115.5	
1980	197.4	177.7	112.5	128.2	114.0	123.8	121.5	115.7	
1981	197.9	180.0	111.5	130.8	112.5	124.1	121.4	117.5	
1982	198.5	177.0	115.0	132.4	114.5	124.5	122.3	115.1	
1983	200.4	182.0	117.9	131.2	118.5	125.7	124.1	118.3	
1984	205.1	191.3	123.2	135.9	120.8	128.7	126.9	124.6	
1985	209.1	197.5	128.4	138.7	124.9	131.2	129.8	128.6	
1986	213.5	201.5	132.2	138.2	128.9	133.9	132.8	131.1	
1987	217.3	207.9	131.1	144.9	134.6	136.3	135.8	135.1	
1988	224.5	216.0	130.5	150.4	139.8	140.8	140.4	140.4	
1989	231.4	221.8	131.9	159.5	142.7	145.2	144.4	144.2	

ANNUAL PERCENTAGE CHANGE

1961	4.4	2.8	5.7	5.5	2.4	4.4	4.0	2.8
1962	4.3	4.1	4.8	2.8	.1	4.3	3.3	4.5
1963	3.1	3.7	-.2	4.0	3.1	3.1	3.0	3.7
1964	4.9	5.3	8.4	3.3	4.7	4.9	4.9	5.3
1965	3.7	4.3	3.7	1.5	1.9	3.7	3.2	4.5
1966	3.3	4.4	1.9	.6	1.3	3.3	2.8	4.7
1967	2.8	2.5	2.5	5.2	1.7	2.8	2.5	2.5
1968	4.8	4.5	3.4	7.8	3.6	4.8	4.5	4.5
1969	6.1	3.7	5.8	5.4	1.6	6.1	5.1	3.8
1970	4.6	1.4	1.2	1.8	1.9	4.6	3.9	1.3
1971	2.4	2.5	2.0	2.5	1.4	2.4	2.2	2.5
1972	3.2	4.5	4.7	4.9	3.2	3.2	3.2	4.6
1973	4.8	4.7	3.0	3.1	6.9	4.8	5.2	4.5
1974	2.2	-1.1	-1.4	2.6	-1.7	2.2	1.3	-1.1
1975	-1.6	-1.0	-.9	3.9	-.8	-1.6	-1.4	-1.0
1976	5.1	3.6	6.2	-.2	2.8	5.1	4.6	3.6
1977	2.7	3.2	1.3	6.8	2.4	2.7	2.6	3.2
1978	2.9	3.8	1.2	5.8	3.6	2.9	3.0	3.7
1979	3.8	1.9	3.3	1.4	2.7	3.8	3.5	1.8
1980	1.8	.1	-.6	2.1	-2.4	1.8	.9	.2
1981	.2	1.3	-.9	2.1	-1.3	.2	-.1	1.5
1982	.3	-1.7	3.1	1.2	1.8	.3	.7	-2.0
1983	1.0	2.8	2.6	-.9	3.5	1.0	1.5	2.7
1984	2.3	5.1	4.4	3.6	1.9	2.3	2.3	5.4
1985	2.0	3.2	4.2	2.0	3.4	2.0	2.3	3.2
1986	2.1	2.1	2.9	-.3	3.2	2.1	2.3	1.9
1987	1.8	3.1	-.8	4.8	4.4	1.8	2.3	3.0
1988	3.3	3.9	-.5	3.8	3.9	3.3	3.3	3.9
1989	3.1	2.7	1.1	6.0	2.0	3.1	2.8	2.7

EUR6: ; B D F I L NL

DS: 3 6 21 0 B8VGD0

(1): ; DK GR E IRL P UK CH A N S SF USA CDN J AUS

EUR9: ; EUR12 EXCL. GR E P

(2): ; GR E P CH A N S SF USA CDN J AUS

A reason for this weak empirical evidence might be, that the founding of the European Economic Community and its later expansion were not such sudden "breakups of undisturbed developments" as assumed by OLSON. As a matter of fact, the internal market was not completed in the early 1960s -- it will hopefully be completed in the early 1990s -- and the joining members of the 1970s and 1980s were allowed to adjust to the needs of EEC policies over several years. Indeed, these events were more or less a "smooth change in institutions" than a "breakup". The smooth change, however, gave public-choice effects the occasion to erode potential positive effects stemming from a weakening of interest groups.

Both, the CECCHINI-report and the BERNHOLZ-paper focus on changes in the situation of the different actors. However, what will be the effects of institutional changes and the internal market programme on the situation and behaviour of different groups within the political decision-making process ?

3.2.1. The Politicians

There will be no change in the situation and behaviour of those national politicians who are in opposition. Their influence and position within the political process will not be much affected by the weakening of the principle of unanimity, although they now cannot always blame the government for decisions made in Council. They may, in fact, lose some influence, because the situation for those national politicians in power will be different.

Although the fact of a personal union at national and European level prevents a change in the distribution of responsibilities from impacting on individual competences of the members of the Council, the strengthening of the principle of majority (Art. 100 a EEC Treaty) has somewhat changed the individual responsibilities on both the European and the national level; contrary to the past, national preferences can now be overruled in the Council.

This downgrading of individual member's power to let national rent-seeking which is reflected in EC directives is quite interesting in the public choice context. On the one hand, it weakens the influence of an individual member to run a national policy, but on the other hand, the real application of the majority principle allows the politicians to evade the direct control of national voters and direct pressure by interest groups in cases where Council directives are working against national rent-seeking activities. The reason is that now the individual member of the Council can use the Council itself as a tool or at least as an alibi. The individual member can pretend that he/she struggled hard to defend national (or particular) interests, but was overruled by the majority. Consequently, the impact of national rent-seeking activities has been weakened.

However, the transition to the new harmonization approach described in the White Paper and prepared by the European Court of Justice - the principle of mutual recognition - brings national politicians and national administrations under further pressure from interest groups, especially from those in industry. The reason for this is that, under the new rules, the satisfaction of national regulations, standards and minimum requirements allows the producer to serve the whole internal market without impediments from national regulations of other member countries. If the regulations in the home country are quite favourable compared to those of other partner countries, they will give a competitive advantage to the home country and vice versa, which looks, at first glance, unjustified. It must, however, first be established if different regulations are justified by different resource shortages at the national level. If, for example, one country applies higher pollution control regulations because pollution is a problem in that specific country, the Government only places a higher price on a safe environment because it is in short supply. If there is a shortage of capital, capital will become more expensive, and if there is a shortage of a safe environment, provision of a safe environment should become more expensive. A less restrictive policy would indirectly give industry an unjustified subsidy in as much that industry has not to pay the full price for using a resource. Nevertheless, it is more efficient to spend additional

resources on national rent-seeking to ease and weaken national regulations and minimum requirements.

Finally, it should not be forgotten that the implementation of the White Paper is already affecting the different actors and sectors. Therefore, it should be expected that the implementation of the White Paper itself will set the rent-seeking armies on the move. Increased pressure from interest groups already before 1992 and in the course of implementing the White Paper is to be expected. Are politicians and the administration prepared for this?

In looking at the European Opposition (the European Parliament) it can be said that its control function has become somewhat more important as the role of Council has become more important (and now more dynamic due to the strengthening of the majority rule) in the fields of social, environment and research policy. Furthermore, the Single European Act and the new version of Article 149 EEC-Treaty gives the Parliament the opportunity to benefit from disagreements within the Council. Article 149 EEC-Treaty lays down that a proposal from the Council changed by the Parliament and transmitted to the Council by the Commission can only be changed again or rejected by the Council by unanimity. By this, the position of the Commission and of the Parliament within the field of forces is strengthened. While up to now a lack of unanimity has led to a blockade in the integration process, e.g. in the field of a common transport policy, it can now be used as a trigger to speed up the integration process. This will, however, result in more attention and perhaps more pressure from interest groups.

3.2.2. The Bureaucrats

Once again a distinction between the national and the European level is necessary.

The bureaucrats at the national level are affected in two ways. On the one hand they are directly addressed by the proposals of the White Paper

relating to public procurement.⁸ According to these proposals bigger procurements have to be advertised internationally and discrimination against foreign tenders is no longer allowed. On the other hand, bureaucrats are affected insofar as the abolition of intra-Community border controls, deregulation in some sheltered sectors and harmonization of national regulations may render many public sector activities obsolete at the national level, may reduce budgets and may lead to a loss of responsibilities. This, of course, is not in the interest of the national administrations.

The European bureaucrats (Commission) and the national bureaucrats on the European level (Secretariat of the Council) will benefit from the shift of responsibilities and the new harmonization and surveillance efforts. Furthermore, the role of the Commission has been enhanced by the Single European Act. Both these opportunities will combine to ensure that European bureaucrats will gain increasing attention from national pressure groups and media. Are they prepared for this?

3.2.3. The interest groups

The situation for interest groups will change dramatically as the White Paper is implemented. Here also different levels of impact must be distinguished.

CASE I : Producers

Let us look at first at those sectors and branches which are explicitly mentioned in the White Paper : the carriers, the banking and insurance sector, telecommunications, the professions, that part of the service sector which is sheltered by professional regulations, i.e. craftsmen and those sectors which will be affected by the changes in public procurement. All these sectors are "threatened" by increased international competition

⁸ It must be borne in mind, however, that public procurement in the definition of the White Paper covers not only the public sector in terms of national accounts, but also the enterprises run by public authorities or controlled by them.

and by a dismantling of historical privileges. The latter may even result in more competition not only from foreign but also from new domestic enterprises. On the other hand, these changes open up new opportunities in the markets of other member countries. The interest groups will, of course, publicise the "threats" far more than the opportunities.

Recent experience⁹ with national deregulation in an international environment yields us two important conclusions :

- (1) National pressure groups struggle very hard to maintain protective and discriminatory national regulations as long as possible. So they do this to avoid liberalising measures which could lead to more competition and new competitors.
- (2) National politicians will be attentive to the needs and complaints of national interest groups especially in those cases where the risk of job losses is prominent and complaints are focused against foreign competitors.

The implementation of the internal market programme and some of the deregulation and liberalization measures have to be decided on the European level under the system of majority rule in the Council. Therefore, it is necessary for affected interest groups in different countries to press in the same direction. Otherwise it may be impossible to prevent the Council voting by majority for deregulation. In this context, it is important to check whether the respective interests and incentives of interest groups in different countries are conducive to such internationally coordinated action and pressure.

In principle, an internationally coordinated pressure is more likely when (1) third parties (non-member countries' producers) bear the main burden and

⁹ In this context, the cases relating to protectionist measures in connection with Article 36 EECT which are brought before the European Court of Justice are of interest : German beer, German sausages and Italian pasta were sheltered against international competition by protectionist measures which were judged by the Court of Justice as incompatible with Article 36 EECT.

when, furthermore, (2) relative competitiveness positions within the Community are not significantly affected. So, it is more likely that European carriers will more vigorously oppose cabotage¹⁰ allowed for extra-EC carriers than cabotage allowed for intra-EC carriers. Within the Community, carriers in small countries would prefer cabotage while those in larger countries would prefer no cabotage to be allowed.¹¹ Consequently, it will become already quite difficult to establish deregulation in that way that cabotage will be allowed for intra-EC carriers; cabotage allowed for extra-EC carriers will not at all be established. This is, however, a stone in the wall of a "Fortress Europe".

CASE II : Trade unions

Trade unions are organized on a subnational level. In some countries, e.g. Germany, they have a more centralized organization while in other countries, e.g. the UK, they are more decentralized. The situation of trade unions is not directly affected by the internal market programme. However, the fact that crossborder transaction costs for capital owners will be reduced in a single market may imply a weakening of the trade unions' position. This will be the case particularly for trade unions in those countries where labour costs (in the broadest sense) are quite high, while the position of unions in countries with quite low labour costs will be strengthened vis-à-vis the other trade unions, but still weakened vis-à-vis capital owners. Therefore, it could be helpful for trade unions as a whole to intensify crossborder co-operation or even merge, at least on the (sub)national level. The incentives to do so are, however, quite weak. International co-operation or subnational mergers will - if this is finally institutionalized - lead to a loss of power and scope for action for the managers of unions' affected. Furthermore, unions in low labour cost countries may try to use their relatively low labour costs to attract more job-creating capital. Consequently, an initial overall weakening of trade unions can be expected as a result of the Internal Market.

¹⁰ Cabotage := fulfilling freight orders which are limited to a country different from the country of the carrier.

¹¹ These different situations and interest structures will be once again discussed in the context of the likelihood of the "Fortress Europe".

CASE III : Latent groups

Bearing in mind that international co-operation among groups with common goals is more likely than co-operation among groups with conflicting goals, one could now expect that the influence of consumers, tax payers or ecological pressure groups will rise, as different national organizations aim at the same goal and attack third parties, e.g. producers. Thus, the likelihood of internationally coordinated action might seem quite high. However, the problem of organization constraints for these latent groups has also to be borne in mind. Some of these groups are not even organized on a national level. So powerful and permanent international action is even less likely. These latent groups may, therefore, even lose influence.

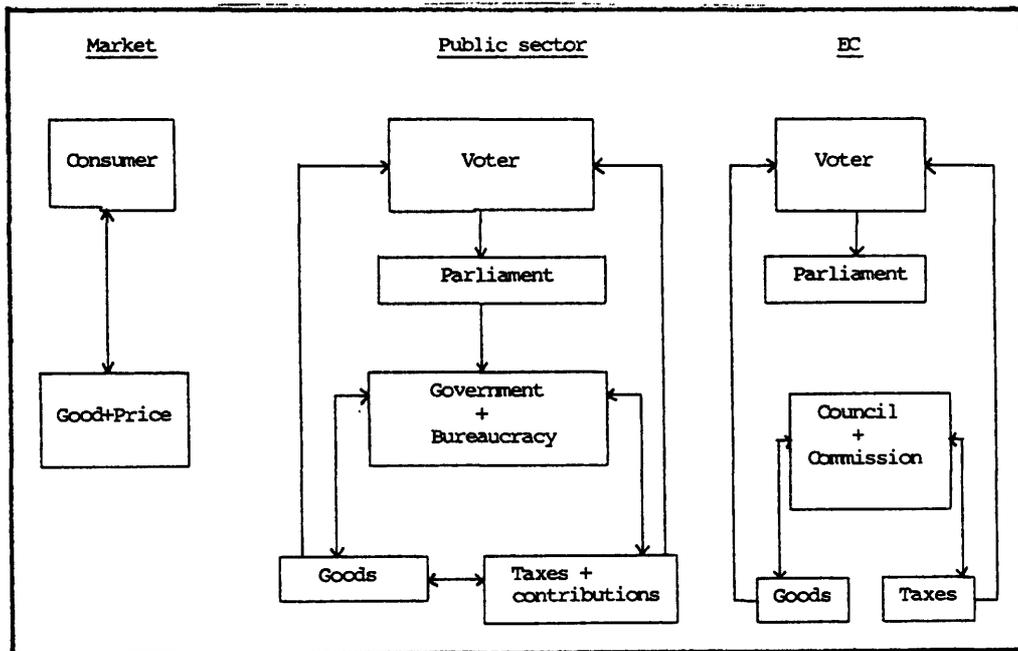
3.2.4. The voters

The voters' situation remains almost unaffected although they could benefit from the completion of the common market as consumers; citizens may realize that there will be no more intra-EC border controls and that the supply of goods and services will be more various. However, neither their influence on the output of the integration process nor their influence on the financing of the integration policies will be changed. It will remain at best marginal, although the control function of the European Parliament, European citizens vote for, will become somewhat more important.

Nevertheless, it will still be the Council who decides what has to be tackled and how it has to be financed (see figure 1). In contradiction to the marketplace where the consumer directly decides which product he needs and how much of his budget he will and can spend the normal (sub)national public provision of goods is realized only indirectly by electing a government which fills the "basket" of goods and services publicly provided. On the European level the individual voter has not even the power to elect the European government which decides upon the European policy "basket" (see figure 1). This further marginalization of the European voter is not alleviated, neither by the internal market programme nor by the Single

European Act. For this reason, the voters' incentives within the political decision-making process will not be changed significantly. Consequently, they will remain rationally uninformed and "rationally ignorant" about European affairs; they will simply hope to benefit from the internal market programme without really trying to influence this programme. In other words, national politicians within the Council can continue their policies without being bothered by voters.

Figure 1 : The role of the voter in the institutional structure of the market, the public sector and the European Communities



4.2.5. The media

In future, there will be a lot of policy issues prepared and decided at the European level. Therefore, the media have to focus more of their resources on the European integration process. It is possible that the media will evolve into a control function similar to that which they now fulfil on the

(sub)national level. However, their power at the European level will remain restricted because of their limited ability to influence voters' attitude since the voter still scarcely matters on the European level. Nevertheless, there may be some opportunity for the media to use moral suasion to influence the attitude of European politicians and bureaucrats.

3.4. SUMMARY

In summarizing this chapter we can say :

- (1) Neither the internal market programme nor the Single European Act will change the situation of the voter or that of the national Opposition. The role of the European Opposition (European Parliament) will be enhanced indirectly, due to its more important control function.
- (2) Politicians in power will have more room for manoeuvre vis-à-vis national parliaments and national pressure groups due to the strengthening of the majority rule. Furthermore, this rule will impact negatively also on their capability to implement EC directives favouring specific national rent-seeking activities within the European integration process.
- (3) As far as bureaucrats are concerned there will be a shift of responsibilities in favour of the bureaucrats at the European level (Commission and Secretariat of the Council).
- (4) Interest groups will be faced with a necessity for greater international co-operation. Well-organized interest groups may benefit from this need; groups with conflicting interests and latent groups will become less influential.
- (5) The principle of mutual recognition will make national rent-seeking activities more attractive.

4. LIKELY OUTCOME OF THE INTERNAL MARKET PROGRAMME

Taking into account the changed structure within the political decision-making process, the individual incentive structure and the incentive structure produced by the institutionalised system, one may speculate on the likely outcome of the political process at both national and European levels. The following paragraphs consider the likely outcome, i.e. the performance of the public sector and political and bureaucratic interventions into the market process and the influence of interest groups.

4.1. THE CONTAINMENT OF THE RISE OF THE PUBLIC SECTOR

The authors of the CECCHINI-report and BERNHOLZ expect that the share of national resources required by the public sector will be reduced as a result of the internal market programme. While the CECCHINI-study bases its assessments on the assumptions that the abolition of crossborder controls and price reductions of bidders in the field of public procurement will reduce input resources, BERNHOLZ is quite optimistic that a rollback of the public sector will emerge due to international competition among governments in favour of less restrictive regulations, lower tax burdens, etc. However, public choice theory does not necessarily support these views. Consider the following :

- (1) Bureaucrats try to increase their budget and to strengthen their influence on the decision-making process. Personal costs and budget reductions may be possible in principle due to the abolition of crossborder controls, but the administration will try to hinder this. For example, compensating national regulations, e.g. more sophisticated national statistics or controls might be established in place of international controls. Furthermore, there may even be an overall increase in resources consumed due to a new or expanded administration at the European level, e.g. a European police, a European body for supervising public procurement regulations.

- (2) As for cost reductions to the public sector due to the opening up of public procurement, the CECCHINI-report expects corresponding reductions of budgets and budget deficits (EMERSON ET AL 1989, p.160). However, this would conflict with the goals of bureaucrats. They normally try to exhaust their budget fully so as to avoid a reduction in their budget limit. A reduction of input prices - if it occurs at all - will, therefore, present the bureaucrats with a new challenge, i.e. how to spend the budgetary resources released after completion of the internal market ! So it is not unlikely that they will not only buy 10 units of a good but 11 if they can get the extra unit at the same price. Furthermore, it might happen that a cheaper foreign product will not be purchased. There are some incentives to favour domestic provision, e.g. the pressure of domestic and local producers and lobby groups on the administration and politicians. To avoid this risk, a European body for ex-post transparency and surveillance is already planned, implying more rather than less bureaucracy. Furthermore, administrations who prefer the somewhat more expansive domestic product to the cheaper foreign product will not be exposed to sanctions, neither to domestic nor to European ones.
- (3) International competition between national tax systems exists. In some countries, recent tax law reforms were combined with a rollback of the public sector/GDP ratio (e.g. in Germany and in the UK). However, it is uncertain, whether this rollback of the public sector was more the result of an international competition among governments, or simply national governments independently rationalising public allocation, stabilization and redistribution activities. It may even have been a combination of both. Indeed, BERNHOLZ explains the change in policy in the UK, the USA, etc. not by increased competition but by the wish to reverse the negative economic impacts of public sector growth (BERNHOLZ 1989, p. 19ff). Furthermore, the verbal justification of tax-law changes and the roll-back of the public sector in Germany and in the UK referred to "overdoing" and not to international competition.

Increased competition will not necessarily lead to a roll-back of the public sector. On the contrary, it can even lead to a larger public sector fuelled by international competition for higher subsidies¹², as in the Federal Republic of Germany, where the Länder and even the municipalities compete to attract capital by offering subsidies, cheap land, etc. These direct and indirect subsidies would have to be financed by the latent groups of the economy, e.g. by increasing indirect taxation.

4.2. THE INFLUENCE OF INTEREST GROUPS AND "FORTRESS EUROPE"

As regards the influence of interest groups three different situations have to be distinguished: (1) the case of national rent-seeking activities as regards national minimum standards, (2) the case of protection against intra-EC competitors and (3) the case of protection against extra-EC competitors.

4.2.1. Minimum standards and national rent-seeking activities

National rent-seeking activities yield more after the implementation of the principle of mutual recognition of national standards. Consequently, national interest groups, i.e. producer groups will struggle for less demanding standards on the national level if this is combined with a reduction of production costs or other regulations working as impediments to innovation and profits. This will hold for all countries; producers of those countries which have the less demanding minimum requirements will, however, at least temporarily benefit from this comparative advantage. Consequently, there will be competition to reduce cost and competition-relevant minimum requirements, e.g. in the banking sector, but also in the manufacturing sector and services like transportation and telecommunication.

European and national politicians and bureaucrats will be prepared to foster a convergence of minimum requirements similar to the least demanding in one of the European countries. This will not be hindered by those groups, at

¹² This risk is clearly also seen by BERNHOLZ. This may be the reason, why he does not allow any subsidization in his scenario (BERNHOLZ 1989, p. 36f).

present benefiting from higher standards as they are worse organized and and less powerful as a consequence of organization problems. However, these groups might perhaps benefit from increased competition, i.e. cost reductions as a result of less demanding minimum requirements might lead to price reductions.

4.2.2. Protection against intra-EC competitors

The internal market programme follows the approach given by the European Court of Justice, e.g. in the cases dealing with the protection of German beer brewers and sausage producers or Italian pasta producers. The internal market programme is in a way a programme to reduce the negative impact of interest groups as regards their successful struggle for protection against intra-EC competitors. The main goal of the programme is to abolish or at least to roll back impediments to the four freedoms of the EEC-Treaty by operationalizing at least some of the measures to reach these freedoms. These impediments, however, are national protectionist regulations, not economically justified and, consequently, the outcome of government failure. As a result of the Single European Act Council decisions in favour of more intra-EC competition normally need only an approval by majority. This means for national interest groups that it will no longer be enough to persuade one government to block such a decision but there is the need to persuade several governments. This, however, will become difficult if goals of individual national interest groups differ.

Therefore, it can be expected that the negative impact of interest groups on intra-community competition and freedom of settlement will be reduced. At least in cases where national protection differs from country to country, i.e. starting positions are different, a breakup of these protections is likely. The liberalization of capital markets and of the transport markets may serve as examples. The weakening of interest groups' influence comes from the fact that national interest groups, even if they belong to the same branch or sector have sometimes conflicting interests. The case of the transport sector was mentioned in this context: while big countries' or transit countries' carriers will opt against cabotage and other market-

entry deregulations small and peripheral countries' carriers will struggle for deregulation as this will allow them to operate on other interesting markets.

However, in some fields interest groups have already been successful in slowing down the process of deregulation as they influenced the internal market programme and the Single European Act itself. As regards liberal professions deregulating Council directives with respect to training and conditions of access for natural persons have to be approved by unanimity (see Article 16 of the Single European Act). Consequently, national rent-seeking activities in this field are still as promising as in the past. Nevertheless, in general a weakening of the negative impact of interest groups as regards intra-EC competition is to be expected.

4.2.3. Protection against extra-EC competitors -- Fortress Europe

Non-European competitors increasingly fear that liberalization of markets within the EC will lead to greater protectionism vis-à-vis third countries. What is the likelihood that these fears of a "Fortress Europe" will be justified ?

In many cases imports of goods and services from third countries to the Community receive discriminatory treatment compared with intra-EC flows. There are two major sources of increased protectionism after 1992. Firstly, there will be a need for changes in rules in cases where we have different bilateral trade regimes within different member countries, e.g. under Article 115 EEC-Treaty. Second, the exposure to more intra-EC competition lets interest groups struggle for higher extra-EC protection.

As regards the first source for increased protection the argumentation is as follows: for example, while there are no constraints for imports of Japanese cars to Germany, other countries apply quota systems. As table 3 shows for 1982/83 there were "only" 50 products affected by import restrictions under Article 115 of the EEC Treaty in Germany while there were more than 500 products burdened by import restrictions in France and Italy.

As the internal market programme does not provide for differential treatment of imports from non-member countries in different member states, the question arises whether a uniform trade regime for the Community will tend towards higher (France, Italy) or lower (Germany) levels of protectionism.

Import restrictions under Article 115 EEC Treaty and anti-dumping procedures are normally implemented on the initiative of well-organized interest groups representing domestic producers, seeking greater protection against competitors from third countries. As can be seen from table 3, interest groups in France and Italy, but also in the UK, Greece and Belgium were significantly more successful in realizing their particular interests than interest groups in Germany or Denmark.

Table 3: Import Restrictions in the EC in 1982-83 Under Article 115 of the EEC Treaty¹
(Number of affected products)²

	Product		Total
	Textiles and clothing ³	Others ⁴	
Belgium/Luxembourg	162	70	232
Denmark	56	51	107
France	208	340	548
Germany, Federal Republic of	36	11	47
Greece	6	247	253
Ireland	64	98	162
Italy	107	459	566
United Kingdom	278	8	286

Source: D. Witteler, "Tarifäre und nichttarifäre Handelshemmnisse in der Bundesrepublik Deutschland—Ausmass und Ursachen," *Die Weltwirtschaft* (Tübingen), No. 1 (1986), p. 142.

¹ Article 115 of the EEC Treaty allows member countries to impose national restrictions against imports from third countries under certain circumstances.

² Product lines of trade statistics.

³ Against Multifiber Arrangement countries.

⁴ Excluding state-trading countries.

Source: LIPSCHITZ et al. 1989

However, is it likely that the power of interest groups, especially those in France and Italy will be so significantly weakened by the internal market programme that there will be no pressure for a "Fortress Europe" from this side? The answer must be No! As already mentioned earlier, a weakening of interest groups can only be expected in those cases, where the shift of responsibilities to the European level and the successful struggle for

protectionist measures to be implemented on this level require (1) on the one hand a concerted action of interest groups of different countries while (2) on the other hand the implementation of such measures is resisted by opposition, either from within the group or from a third group. It may be true that a widening of bilateral import restrictions with EC-wide restrictions demands internationally concerted action. However, there are no countervailing conflicts between interest groups of different countries, e.g. Italian car producers are interested in reduced competition from Japanese car producers, but so are German car producers.¹³

What will be the likely reaction of politicians and bureaucrats to increasing pressure for greater protection? A Fortress Europe will not emerge if politicians and bureaucrats successfully resist this pressure. To do so, they need additional support either from the internal market programme or from somewhere else. As regards the internal market programme, it does not give additional incentives to politicians and the administration to face the pressure. Furthermore, foreign competitors directly and negatively affected by demands for protection are not clients of European politicians, and European consumers (e.g. car buyers) do not participate in the decision-making procedure. So there will be a tendency to (temporarily) widen narrow import restrictions to EC-wide restrictions. Only in cases where non-member countries' producers get the strong support of their government, bargaining between powerful non-member governments and the Council might alleviate the risk of a "Fortress Europe"; i.e. the fortress will only be avoided if the Council is exposed to heavy external pressure.

A second source of increase in protectionism comes from another element of the internal market programme. Liberalization of markets will expose some services in different countries leading to greater competition in those countries, e.g. in the field of banking and insurance services or carrier services. Therefore, the affected groups may ask for compensating extra-EC protection, as was discussed under the "reciprocity" item for the banking

¹³ German car producers, however, could remain in the back stage of this struggle for a Europewide import restriction because they can assume that French and Italian producers will create the necessary pressure and because German interests in foreign markets are relatively more important.

and insurance system. As such efforts are focused against third country competitors, they may be supported by pressure groups from other countries and thus may be more readily accepted by politicians and bureaucrats.

All in all, the internal market programme is unlikely to prevent a tendency towards a Fortress Europe, i.e. higher extra-EC protection, while the necessary change in regulations will reinforce protectionist pressures.

4.3. SOME EVIDENCE

One could now argue that this is a too pessimistic view concerning public-choice processes which erode the advantages of the internal market right from the beginning. It could be stressed that the formation of powerful interest groups on a European level takes time and that deregulation will take place before European interest groups will have been organized adequately. But in how far do these hopes mirror actual developments? To deal with these arguments let us look for some evidence.

If public-choice processes were important despite the internal market programme one would e.g. expect

- significant delays for those deregulations which increase international competition, namely extra-EC competition and which reduce international protection as compared to those deregulations which e.g. reduce cost-relevant minimum requirements and
- significant delays for those directives, mentioned in the white book of 1985, which reduce the room for manoeuvre and degrees of freedom for national politicians (namely the power to tax) and bureaucrats (e.g. control rights or public procurement) as compared to those directives which harmonize administrative procedures without affecting politicians' and bureaucrats' budgets and competences.

If public-choice processes were, however, not eroding the advantages of the internal market right from the beginning no significant time lags in the

adoption and implementation of public-choice sensitive and not sensitive directives would to be expected.

An analysis of the different EC-Commission's reports "Concerning the implementation of the White Paper on the Completion of the Internal Market" indicates, however, that there seems to be indeed a significant difference between how the Council deals with public-choice sensitive Commission's proposals and how it adopts directives not strongly affected by public-choice processes:

- Although the achievement of the internal market should lead in practice to the disappearance of Article 115 of the EEC-Treaty ("national commercial policy measures") there are still more than 100 national measures accepted by the Commission each year, which allow national authorities to reduce competition from extra-EC countries by limiting respective extra-EC imports.
- No progress can be recorded as regards harmonization or co-operation in the field of taxation. Several proposals of the Commission had to be withdrawn as the Council was not willing to accept them. No proposal related to the harmonization of indirect taxation has yet passed EC-legislation although 15 out of 18 proposals related to this subject and at present on the Council table date from before 1985.
- Also the adoption of directives aiming at free movement for labour and the professions and at a common market for services has been delayed by two or more years. The main bulk of these proposals was — according to the original timetable of the White Paper — foreseen to be adopted by the Council in the course of the 1987/88 period. But many of them were adopted not earlier than in end-1989 or are not yet adopted. This holds especially for those fields intensively regulated at the national level, e.g. road transport. Namely in these fields the time-span between the date of a respective Commission proposal and the final adoption by the Council is extremely long.

Furthermore, it has to be borne in mind that directives most sensitive to public-choice processes are subject to an unanimous adoption by the Council. This procedure, however, significantly prolongates the final decision-making process in the Council.

4.4. SUMMARY

In chapter four we had to realize that some hopes related with the implementation of the internal market programme do not consider the effects of public-choice processes. The incentive structure and the likely behaviour of bureaucrats tend to undermine the hopes of BERNHOLZ and the arguments of the CECCHINI-report that there will be a welfare increasing effect after 1992 from a rollback of the public sector.¹⁴ Already BERNHOLZ himself introduces several caveats indicating the evidence of severe risks coming from public-choice effects [BERNHOLZ 1989, p. 37ff].

Nevertheless, empirical evidence exists for a rollback of the public sector/GDP ratio and for an international tendency to reduce marginal tax rates. As this holds, however, not only for some EC-countries but also for non-member countries, as e.g. the United States, Japan or Austria this might not be the result of the internal market programme but it might be a reaction on overdoing in the past.

As regards the influence of interest groups we distinguished between their impact on (1) national minimum requirements, on (2) intra-EC competition and on (3) extra-EC competition. Public choice and empirical evidence indicate that there could be, indeed, a tendency to reduce minimum requirements and to increase intra-EC competition. However, there is also a tendency to increase extra-EC protection, discussed under the item "Fortress Europe".

¹⁴ If there is finally an unavoidable reduction of the public sector, it might mainly come from a reduction of public investment expenditure, as cuts in infrastructural investments do not hurt that soon and that obviously.

5. REDUCING THE RISKS OF INEFFICIENCIES

So far, we have seen that there is only little reason to assume that the impact of interest groups on the public provision process will be contained or even reduced by the internal market programme or by the Single European Act. Furthermore, it is unlikely that the internal market programme will be accompanied by a significant decline in the public sector share of output. Therefore, the means by which the negative impacts of a growing public sector and of the increasing influence of interest groups can be alleviated now needs to be examined.

To deal with this issue it is necessary to look once again at the reasons for the negative impact of interest groups and for government failures.

5.1. THE NEGATIVE IMPACT OF INTEREST GROUPS

The key question of this paragraph is, how the negative influence of pressure groups can be reduced and which elements of the decision-making process should be improved. To answer this question it is necessary, to look at the determinants of the rather negative impact of interest groups.

Why do interest groups have a negative rather than a positive effect on the political decision-making process? Why is rent-seeking not a pareto-optimal process, i.e. groups benefiting from rent-seeking activities have to pay-out those who are burdened by these activities? An examination of rent-seeking processes gives us an answer to these questions.

Rent-seeking is not a bargaining process between those groups who want to increase their profits and those who are burdened, e.g. via higher taxes or higher prices. It is a bargaining process between those who initiate this process and a third group who also hopes to benefit, e.g. competitors or politicians. The burdened group does not participate or is not powerful enough to influence the bargaining process. So measures discriminating extra-EC competitors are not bargained between EC-producers and EC-consumers or extra-EC competitors but normally between EC-producers and EC-bureaucrats

and politicians. The result of such inefficient bargaining processes might be that the additional benefit of the bargaining groups is minor to the burden put on the shoulders of not participating groups.

This answer leads, however, to a further set of questions: Why do groups potentially burdened not participate in these rent-seeking bargainings? Why are they less powerful than potential beneficiaries of such activities? The answer, already given in chapter 2.3 under the item "low-benefit problem" was that there is an asymmetry in organizing pressure groups and in the influence of interest groups on politicians and bureaucrats. The most pressing groups are groups where the potential gain from rent-seeking represents a substantial proportion of their members' budget. These groups tend to be better organized than other groups and are extremely interested in having influence on politicians. Car producers and car users might serve as an example. The individual car user buys a new car every five or ten years. So it will have only relative little consequence for his budget if a lack of competition as a result of cartellization or market-entry constraints for Japanese and other extra-EC producers has led to a price increase of, let's say 10% as compared to a competitive market. This is only very little as compared to his ten-years budget and as compared to what such a price increase means for the producer. Consequently, car users are less present to hinder rent-seeking activities of car producers.

While this partly explains the asymmetry in the participation of rent-seeking bargaining it does not explain why the most influential groups are not representing big groups but often only small groups. Why do small groups of producers have more influence on the political decision-making process on all levels, including the European one, than small groups of, e.g. consumers? In other words: why have some groups to be very big before becoming influential while others do not need to be big? And why has the chairman of e.g. Daimler Benz or Deutsche Bank more influence on German politicians than the chairman of a small or medium enterprise? Two reasons shall be mentioned here. One is, that because of the low-benefit problem some groups' members do not press as hard as other groups' members do. While

e.g. car producers have only to push in the field where the car market is affected consumers have to follow and push on all markets.

The other reason to be mentioned here is that "small men's" groups count less in terms of their ability to influence reelection chances for politicians. While members of consumer organizations can only "threat" to influence the voting behaviour of their friends and family members, entrepreneurs are — at least in the eyes of politicians — also representants of their staff and they can by this "threat" to influence the voting behaviour of their employees and their friends and family members. Entrepreneurs might argue that a measure which is in favour of an enterprise is also in favour of its employees While a measure or a situation (e.g. strong competition) which is bad for the profit of an entrepreneur is also bad for the employees. So the number of members of an entrepreneurial pressing group is in the eyes of politicians also corrected and increased by the number of affected workers while no correction is made in cases of e.g. consumer groups.

After having clarified these important aspects of rent-seeking processes and the reason for the bias of activities in favour of small and well-organized groups we can now look for countermeasures to reduce such a negative impact.

A three-fold strategy might allow a reduction in the negative impact of pressure groups. Firstly, interest groups' biased influence has to be weakened by building up institutionalized counter-influences. Second, greater transparency in the whole decision-making process and the building up non-institutional counter-influences within the system is needed. Finally, the intensity of public interventions into markets without market failures has to be limited by institutional means.

(1) A systematic introduction of all affected interest groups and sectors into the decision-making process may improve the outcome of the political process. The theory of externalities may be helpful in this context, i.e. to look systematically for effects and side effects (externalities) of measures

and interventions under consideration. So it could be more efficient not only to hear the view of domestic producers on antidumping laws, but also to hear how domestic clients and consumers would rate the impacts of an antidumping law. This consideration of, e.g. the consumers' viewpoint should, however, be institutionalized and not heard almost accidentally, as at present. Thus, the systematic participation of all interest groups in the decision-making process can be ensured and all relevant informations will similarly be systematically made available to the administration and to the politicians. Already this might help to avoid the risk of hampering extra-EC competitors and to support the "Fortress Europe".

(2) Greater transparency would mean greater accountability to the public regarding who benefits and who pays for any measure and what the costs of measures are. How can this be achieved? One possibility is to investigate systematically into side-effects of planned market interventions, e.g. market-entry regulations, and to look for less intensive interventions. So all measures of the internal market programme and all respective Council decisions would have to be checked as to whether they still allow for market-entry and other competition-reducing or discriminating policies. Another possibility might be to finance allocative European policies according to the equivalence principle and to loosen the principle of non-affectation. Although European policies and especially the internal market programme are not particularly expenditure-intensive, the equivalence principle could be used more. European industry would have to pay an R&D levy to finance new R&D programs of the EEC, if it has finally been decided to support R&D at EEC level, users of EC-financed infrastructure would have to pay an infrastructure toll, etc. In this way, beneficiaries have to pay for what they use (e.g. bridges, tunnels) while political institutions at the European level would only influence the allocation of financial resources and help to raise the money on the (capital) markets. The situation for the beneficiary would change dramatically. European industry would finance European research programmes from which it benefits, etc. Up to now, the burden of new programmes is distributed among all tax payers while the pressure groups are homogenous in their struggle for increased financial resources. The switch to the equivalence principle would hopefully

lead to a discussion within the beneficiary groups, on the choice between claiming for more programmes and paying higher R&D tax or R&D contributions, etc.

A third possibility is to improve transparency is by restructuring the system of benefits, e.g. to change the redistribution component of the Common Agricultural Policy so that farmers receive an explicit income subsidy which is linked to the income and not an implicit subsidy via allocative interventions into the market mechanism for agricultural products. The current system hides the level of subsidy to each farmer and whether these subsidies are related to income levels. The new system would make the subsidy to each farmer public knowledge and thereby ensure that the poorest farmers would get highest subsidies. The justification for subsidising agricultural income could then be openly debated.

(3) All these changes in existing procedures would help to reduce the asymmetric influence of pressure groups by building up counter-influences within affected groups or by activating other pressure groups. As these measures might not be sufficient additional institutional safeguards should be implemented which reduce possibilities for rent-seeking activities. Some shall be mentioned here:

- limiting sectoral state aid on the national and sub-national level by law, e.g. similar to public borrowing limits in several countries. Consequently, new state aids will only be granted if other state aids are cut. At the European level, no sectoral state aids should perhaps be allowed at all;
- all state aids should be time limited and degressive in their design. This would support the necessary structural adjustment process;
- statutory market-entry and price regulations should also be time limited.

This list of institutional safeguards against rent-seeking activities is not at all complete or sufficient. It gives, however, a first impression, with

which means the negative impact of rent-seeking activities could be reduced. Furthermore, it is also necessary to change the incentives of politicians and bureaucrats.

5.2. THE INCENTIVES OF POLITICIANS AND BUREAUCRATS

The incentives to politicians and bureaucrats, provided by the institutional system, are quite different from those given to managers in the private sector. This difference in incentives leads to inefficiencies and thus government failures. Three elements of this problem are now considered : one is the input orientation of the public sector, the second is the lack of control on the legislature and executive and finally the lack of positive and negative strokes for the performance of bureaucrats and politicians. The problems with incentive structures is a reality on all levels of Government including the European level.

- (1) One reason for government failure is the input-orientation of the public sector and the public budget. While private sector enterprises and their managers are output-orientated (the goal is profit), ministries and bureaucrats are input-orientated because of a lack of operationalized output goals. The input-orientation of the budgetary system, for example, encourages both bureaucrats and politicians to increase input, i.e. financial resources, and not output. This leads to an increase of resources claimed by the public sector and discourages efficiency in the provision of public services. As regards non-expenditure-related programs and interventions, e.g. anti-dumping measures or other tariff and non-tariff trade barriers a similar argumentation is possible: After implementing a protectionist measure politicians and bureaucrats look only how effective the measure (input) is, without caring about the output, e.g. competition and price-setting behaviour in the protected branch. Therefore, such measures should be time limited and the proof that (1) a continuation of the measure under consideration is necessary and (2) that it is a better alternative compared to others should be provided in an operational manner by those who demand its continuation.

(2) The absence of operational output goals is one item which makes it difficult for both, the opposition and the voter to blame the government or the administration for not having fulfilled its targets. In the case of the EC, the voter or the Opposition (the European Parliament) have not even the power to make the Council and the Commission accountable for their actions.¹⁵ This may explain, why it has been possible to run the Common Agricultural Policy for more than 20 years. It could perhaps be helpful to give the Parliament and not the national governments the power and responsibility to accept or refuse every individual member of the Commission every four years. That would provide the individual Commissioner with a greater incentive to take account of the European Parliament view in his sphere of activity. The influence of subnational partial interest groups could perhaps also be reduced at least relative to the Commission.

(3) Unlike the market, the public sector is not greatly affected by business cycles, which lead to employment fluctuations, bankruptcies and the selection effects of competition. The absence of efficiency-supporting cyclical selection in combination with the risk-reducing statutes applying to civil servants have protected bureaucrats from censure when individual output is inadequate or when bureaucrats were too prepared to fulfill rent-seeking demands. The institutional structure of the Communities is partly a replica of national structures and thus the incentive structure has similarly been replicated. In the short run, no changes seem likely. Nevertheless, a reform of the incentive structure should be put on the policy agenda. Major improvements could be achieved by a reform of statutes applying to civil servants.

A combination of these three items has led to politicians and bureaucrats seeking more powers (higher budgets) and less responsibility. This struggle still takes place on all levels of government. The recommendation in this context must be that, in looking at the future of European integration, a

¹⁵ The only possibility the Parliament has to "punish" the Council is to bring it to the Court of Justice. The Parliament has done this once in the field of Common Transport Policy. The Commission can only be "punished" by refusing the visa for a Budget. In such a case the entire Commission is dismissed. This has, however, never happened up to now.

change in the institutionalized process should be guaranteed so that new powers are always accompanied by corresponding responsibilities and that all programmes have to be evaluated as regards their final output.

5.3. THE ILL-INFORMED AND UNINTERESTED VOTER

Government failure is not a problem peculiar to European integration; it is a common problem in the provision of public services. In a way the internal market programme is a tool to reduce and cut back national government failure in several fields of allocation policy, e.g. not economically justified market-entry regulations. Therefore, it should be avoided that national government failure will be replaced by a European one.

An important source of government failure can be identified in the control institutions provided by the democratic system - the voter's control on government - which is, in reality, quite inadequate. Often, it is necessary for the media to fulfil the role of controlling politicians and bureaucrats. Thus, any (European) policy which is intended to reduce (European) government failures has to improve the incentive structure of the (European) voter. the voter's incentive structure, however, is a result of the institutionalized system. The ideal solution is to afford the (European) voter, as a participant in the political process, the same power as that of the consumer in the marketplace.

However, there are many institutional constraints and failures within the European political decision-making process which discourage the voter from acquiring information and giving him the same power as in the marketplace. These constraints are, of course, not only evident on the European level, but also on the national level. In a way these problems within European institutions only mirror problems which already exist within the national structures.

What does this mean in the European context and for the European political decision-making process ?

As already pointed out in chapter 3.2 the European voter has no power to directly influence the provision of goods at European level. To counter this, it would be necessary (and not only on the European level) to reinforce the principle of "uno acto" in voting so that a voting decision is not split into one which shapes the "benefit" structure and another which shapes the cost and "financing" structure (e.g. by the Agricultural Council or the Research & Development Council and the Financial Council). On the contrary, a decision on any measure should include a simultaneous decision on financing these measures. A minimum requirement on the European level would, therefore, be the establishment of Common Councils, e.g. agriculture and finance. To give the voter more power, however, requires a reduction in the power and independence of existing institutions.

Necessary reforms are unlikely to take place in the near future as the present situation is not characterized by the famous "curtain of uncertainty" about the future situation of the present actors. In other words, those institutions which are in power and have a high margin of manoeuvre in their operations are also in charge of reforming themselves. Since they are aware that they would lose power in any reform and would have to introduce greater transparency into the system, they are not willing to undertake such a reform.

In looking at less ambitious reform measures we will find the problematic principle of non-affectation.¹⁶ To avoid the inefficiencies resulting from this principle, the EC budget could be split into different budgets with different fiscal resources, e.g. one for agriculture, one for research and development, one for structural funds, etc.. Responsible politicians for these budgets would have to look for sources to finance their expenditures. This would at least ensure greater transparency in the financing of different policies. Furthermore, the individual budgets would no longer compete with each other for resources from total public revenues but would have to compete with the private sector. The Council for Research and

¹⁶ This principle means that all policies are financed out of total available receipts and no receipt is affected to a special expenditure programme. The introduction of this principle of non-affectation is sometimes called the "first fall of man" of public finance (GROSSEKETTNER 1987, p. 405).

Development would not have to justify an increase in the R&D fee expenditure on its policies to the Financial Council but it would have to justify it to the enterprise sector. Public spending would shift away from input orientation (how much tax receipts are available ?) to more output-orientation (is it worthwhile to collect money for this from the private sector?). The recommendation is therefore: To attach prices to policies and let the groups benefiting from a policy be responsible for its financing, also. However, considering the results of the public choice theory, this is quite unlikely to happen for the time being. Nevertheless, one should continue to struggle for such reforms.

6. CONCLUDING REMARKS

There are opportunities and risks connected with the completion of the internal market - possibilities of increased growth, employment, and competition for enterprises and governments. The risks shown in this paper and analysed with the help of the public choice theory do not greatly affect the short-term opportunities but are more relevant to the medium and long term performance. Risks are seen (in accordance with the view of BERNHOLZ) as referring to the influence of interest groups, which may lead to a Fortress Europe and to competition for subsidies. Furthermore, the attitude of national politicians in allowing mergers and co-operation on both national and international level may lead to a monopolisation of the European market in the long run. The reasons for this more gloomy picture are the asymmetric influence of interest groups combined with certain institutional details of the political decision-making process supporting the danger of government failure, especially on the European level.

Public awareness of the internal market's effect in increasing the asymmetric influence among interest groups must be increased. The reason for this interaction of asymmetry is that the first groups reorganized at international level will be the small and already well organized (producer) groups, while those, which already have problems with organization on the national level (consumers, tax payers but also trade unions), will have even greater problems on the European level.

The institutionalized problems, which mainly result in an undisturbed interplay between interest groups, politicians and bureaucrats at the European level may lead to welfare losses for non-participating groups. Furthermore, it is uncertain whether the so-called "Fortress Europe" can be avoided, when one considers that competitors from outside the EC have little influence on this interplay, while interference from within the EC will also remain quite weak.

Some hints have been given in chapter 5 on measures to reduce these risks of welfare loss. The most important measure is a more systematic introduction of all affected groups into the institutionalized decision-making process, especially if they are not well-organized on the national level. A second measure is a reform of the financing structure to increase transparency of costs and benefits by switching to equivalence financing and by weakening the principle of non-affectation. Both measures should result in a reduction in the influence of minority interest groups and a strengthening of the position of consumers and voters. This measure could be further strengthened by giving the Parliament the right to nominate or to refuse individual Commissioners.

Some items touched in this paper go beyond the 1992 deadline. This is because the problems are more fundamental. Nevertheless, they still affect the final outcome of the internal market programme. Easy solutions to these problems cannot be presented in this paper. However, knowledge of the risks may make it easier for the people and institutions in charge to face them. Thus, additional and more detailed research in this field is clearly desirable. Furthermore, the analytical tool of public choice theory, used in this paper, could also be applied in redesigning the political and economic structures of Eastern European countries. Some of the recommendations, briefly sketched in chapter 5, might also be worthwhile to be discussed in this different context.

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