

**COMPLETING EUROPE'S INTERNAL MARKET:  
IMPLICATIONS FOR CANADIAN POLICY**

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## Introduction

The early 1990s may find Canada on the threshold of a dramatically changed international trading environment. These changes will result from the confluence of four, essentially independent, factors affecting international trade. The first, and the one with the highest visibility in Canada, is the Canada-US Free Trade Agreement (FTA). The major provisions of the FTA will be coming into force in the first few years of the new decade, and by changing the rules of the continental American economy, promise to alter substantially Canada's trading context.<sup>1</sup> At the same time, the rules governing the international trading context will themselves be coming under review, as the General Agreement on Tariffs and Trade (GATT) meets to consider the next round of trade liberalisation measures (the so-called Uruguay Round). The third element of this changing context is the rise in power of the trading nations of the Asian-Pacific region, and the consequent shift in international economic focus to the Pacific rim. The final change that could substantially alter Canada's international trading environment is the project, currently underway in Europe, to complete the European Community's (EC) internal market by the end of 1992.

Given Canada's tremendous dependence upon international trade for her economic well-being, such a confluence of important changes deserves our careful attention. While government, business and academic analysis has focused on the first three elements listed, scant attention has been paid to the fourth.<sup>2</sup> This is, perhaps, not surprising. The increasing importance of the Pacific rim has been recognised for several years now, GATT has consistently been central to Canadian trade policy, and the sheer magnitude of Canada's involvement in the FTA has meant that these three have dominated the discussions of the future of international trade. In addition, the failure of the 1976 Framework Agreement between Canada and the EC to meet its expectations for an improved trading relationship, has served to reduce further the attention paid to this relationship.<sup>3</sup> However, the completion of the internal market of the EC will create the largest single market in the world, and it will do so in a Community that is Canada's largest single trading partner after the United States.<sup>4</sup>

While it might be understandable, such a neglect of the potential impact for Canada of the completion of the internal market is not excusable. The 1992 project in Europe promises to be one of the most significant developments of the contemporary international political economy, and Canadians need to be ready to meet the challenges and opportunities it presents. The focus of the present paper is to consider these challenges and Canada's response from the perspective of government trade policy. While obviously industry will need to consider the specific effects of the 1992 project, it is for the government to set the broad goals for the Canadian economy in light of a changed international environment. This paper's object is to examine, first of all, the recent patterns of the trading relations between Canada and the EC, and the current trade policy of the Canadian government, and thus the expectations Canada has for the future of this trading relationship. Having considered the context of the trading relationship, the project to complete the internal market by 1992 will be examined. The paper will then consider the expectations and the likely results of the

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<sup>1</sup> For a useful collection of essays presenting contending views of the effects of the FTA, see Marc Gold and David Leyton-Brown eds., *Trade-offs on Free Trade*, (Toronto: Carswell, 1988).

<sup>2</sup> The one full length study of Canada-EC economic issues, published in 1986, notes the dearth of attention that has been paid to this relationship. As the author notes, this is in some ways surprising, given the strong historical links between the two sides, and the paradoxically weak trading relationship. N.G. Papadopoulos, *Canada and the European Community: An Uncomfortable Partnership*, (Montreal: The Institute for Research on Public Policy, 1986), 1-3, 37-38. (It is indicative of this lack of scholarly attention that a full study of the relationship has not been published since the passage of the Single European Act and the beginning of the project to complete the internal market.)

<sup>3</sup> As an example of the pall this failure has thrown on the consideration of Canada-Community relations, in a 1983 study of the EC, the short chapter on Canadian-EC relations is devoted entirely to the failure of the Framework Agreement relative to the expectations for it. Robert Boardman, 'The European Community and Canada,' in Juliet Lodge ed., *Institutions and Policies of the European Community*, (New York: St. Martin's Press, 1983), 196-202.

<sup>4</sup> Papadopoulos, *Canada*, 17-19. Trade is the one area of EC international policy that is completely under the auspices of the Community. It is the community, through the Common Customs Tariff and its exclusive ability to negotiate commercial agreements, that sets trade policy for the EC as a whole. Thus, when discussing the trading relationship with EC countries, it is proper to consider the relationship with the EC as a whole. This does not mean, however, that countries always do. In fact, Canada tends to consider the individual members' relationships with Canada, rather than the Community's. In addition, the individual countries do influence their own trade, and one of the goals of 1992 is to remove their ability to do so -- to complete not only the internal market, but by doing so, the customs union as well. For a discussion of the problems of the incomplete customs union see Anthony J.C. Kerr, *The Common Market and how it works*, 3<sup>rd</sup> ed., (Oxford: Pergamon Press, 1986), 177-84.

programme, and how these results will influence Canada's position. Finally, a set of conclusions will be drawn from this analysis for the conduct of Canadian trade in the face of 1992.

## Trade And Canadian Policy

When the Mulroney government ended the long Liberal rule in Canada, it pledged to improve Canada's economic performance, in large measure on the back of improved international trade. Central to that policy, of course, has been the negotiation of a Free Trade Agreement with the United States, but this is not the only focus of Canada's trading aspirations. The first task is thus to examine the trade policy set out by the Federal government in face of the changing international economic context in order to identify the government's priorities, and the means it has chosen to reach its goals. In particular, this discussion must address the government's approach to Europe 1992, and the policy it is following to cope with the changes that this will introduce.

In a series of speeches in both Europe and Canada, the Minister for International Trade, John Crosbie, has outlined the essential outlook of the Mulroney government on international trade and its strategy to improve Canada's trading position in response to the changing environment. The government begins by accepting, in Crosbie's words:

the emergence of the global triad -- the three great pillars of economic activity in the global arena:

- North America
- the European Community; and
- the Japanese-centred, Asia-Pacific market.

These three mega markets are, of course, not new. Trade within each region has long been growing rapidly. Many of the institutional arrangements that underpin the triad, like the Treaty of Rome in Europe [sic] and the Canada-US Auto Pact, are decades old. And the 40 year old link between these three pillars is the GATT.<sup>5</sup>

In order to respond to these changes in the international economy, the government has suggested a two pronged strategy: 'One was to improve the ability of our companies to compete; and the second was to improve their opportunity to participate in all 3 markets.'<sup>6</sup> In addition, it should be noted that the principal focus of this trading effort is the export of manufactures. While commodity trade is essential to overall Canadian trade, the government is hoping to improve industrial (particularly high technology) competitiveness and markets, as this is where the greatest trading returns are to be found.<sup>7</sup> This will take on special relevance as the shape of our trading relationship with the EC is examined.

The central pillar in the government's strategy has been the FTA. It is designed to address both of Canada's trading concerns. By removing the barriers, both tariff and non-tariff, between the two countries, the FTA is designed to ensure Canadian access to the large American market. In addition, by opening the Canadian market to American competition, and allowing Canadian firms to compete in the American market, it is hoped that Canada's trade competitiveness will be enhanced. The government's second approach has been through the Uruguay Round of the GATT. Canada hopes to build on the principles of the FTA to allow GATT to begin regulating trade in services and eliminating non-tariff as well as tariff barriers. It is through the GATT negotiations that Canada hopes to ensure its access to both the European and Asian-Pacific markets.

In itself, addressing the three major markets in the context of the Multilateral Trade Negotiations seems to be a reasonable strategy. What this brief overview does not indicate, however, is the differing emphases that the Mulroney government has placed on each of the three markets. As Jeffrey Simpson has noted, Canada has increasingly focused on the US and Pacific Rim, to the exclusion of the European Community:

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<sup>5</sup> John Crosbie, 'Closing Remarks by the Honourable John Crosbie, Minister for International Trade, at the Business Leaders' Conference on Europe 1992,' External Affairs Canada, *Statements and Speeches*, 89/10, April 10, 1989, 1.

<sup>6</sup> Crosbie, 'Closing Remarks,' 2.

<sup>7</sup> See James Kelleher, 'How to Secure and Enhance Canadian Access to Export Markets,' Government of Canada, Discussion Paper.

After investing many hopes in a deeper economic relationship with Europe a decade ago, Canadians have turned to the United States and the countries of the Pacific Rim. For the first time in Canada's history, trade with Pacific Rim countries last year [1985] eclipsed that with the Community. The focus of the conservative Government ... remains first on the United States, second on the Pacific Rim and only third on the Community.<sup>8</sup>

This focus becomes obvious in examining the government's own discussions of international trade. For example, in a discussion paper on improving Canada's export position, the government, to all intents and purposes, ignored the EC. The bulk of the paper, which was prepared prior to the opening of talks leading to the FTA, considered the importance of the GATT and the trade negotiations with the United States, while Europe was mentioned only in passing. In addition, what little attention was paid to Western Europe was addressed to the area as a whole. The EC was not singled out from the other non-Communist European states as worthy of special consideration.

The passage in 1987 of the Single European Act (SEA) and the beginning of the 1992 project have changed this somewhat, but the policy response has been muted at best. The announced policy is a four-part approach: 'using the GATT as a framework for Canadian-Community relations; detailed, ongoing analysis of 1992 developments; the encouragement of strategic European alliances; and improving on international business skills.'<sup>9</sup> While this may appear to be a concerted effort in the face of an unknown challenge, a less self-interested appraisal suggests that there is less here than meets the eye:

Although there can be little dispute about the elements and direction of federal efforts with respect to 1992, the speed with which External Affairs is addressing these issues and the paucity of resources devoted to them is a cause for concern. Of concern also is the contrast with the government efforts in the US, where the Department of Commerce has already initiated a major campaign to alert and inform its business Community about the EC single market. The United States Trade Representative and Treasury are also taking a much more aggressive approach to potential market access issues.<sup>10</sup>

While it is reasonable to suggest that a more considered approach is needed, the specifics of such an approach cannot even be outlined until Canada's requirements for the trading relationship with the EC have been considered. It is only against the government's expectations for Canada's future trade that the impact of 1992 can usefully be judged. The government is seeking improved market access, but improved access for increasingly competitive high-end exports. In order to judge such possibilities, it is necessary first to review the recent relationship between Canada and the EC.

## Canadian Trade With The European Community

In the early 1970s Canada was faced with another potentially serious shift in her trading context. Our second largest trading partner, the United Kingdom, was set to join the EC, and in our largest, President Nixon was instituting policies harmful to Canadian trade. In response, Prime Minister Trudeau launched his third option policy in order to try to diversify Canada's international economic relationships so as to avoid being economically swallowed by the powerful US economy. One element of this new policy was the Framework Agreement with the EC, signed in 1976.<sup>11</sup> While the wording was vague, and the Agreement set out no specific obligations, the intent of the Framework agreement was to encourage cooperation so as to increase trade between Canada and the EC. Unfortunately, in this it has failed.<sup>12</sup>

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<sup>8</sup> Jeffrey Simpson, 'EC-Canada Trade Suffers Slowdown,' *Europe*, 254, March 1986, 14.

<sup>9</sup> Crosbie, 'Closing Remarks,' 3.

<sup>10</sup> Ontario Ministry of Industry Trade and Technology, *Europe 1992: Implications for Ontario on the Completion of the Single European Community Market*, October 1988, 96-97. This paper was prepared, however, not by the Ministry, but by an independent research firm, Hill Sloan Associates.

The lack of attention being paid by the Canadian government to the problem is amply demonstrated by visiting the library of the Department of External Affairs in Ottawa. With the exception of a single report (See note 59 below) which focuses on the effects of the market completion on Europe, there are no assessments of the likely impact of the 1992 project.

<sup>11</sup> Boardman, 'European Community,' 196-97. For a more general discussion of the Third Option in the context of Canadian foreign policy under Trudeau, see Michael Tucker, *Canadian Foreign Policy*, (Toronto: McGraw-Hill Ryerson, 1980), particularly the Conclusion.

<sup>12</sup> A brief analysis of the failure of the Framework Agreement was prepared by Jeffrey Simpson to mark the Agreement's tenth anniversary. Simpson, 'EC-Canada,' 14-15.

N.G. Papadopoulos, in his study of the economic relationship between the EC and Canada, presents an overview of trade from 1968. From that point on, both Canadian imports from the EC and its exports to the EC have dropped steadily as a proportion of Canada's total imports and exports. While the import trend reversed slightly in 1980, the overall impression is one of a trade relationship that is declining in importance.<sup>13</sup> This does not necessarily suggest a failure in the Framework Agreement, as the Agreement was part of a diversification strategy, and such a trend could indicate a diversification of Canadian trade. However, over essentially the same period the proportion of our trade that was with the United States increased, suggesting instead that Canada's trade was increasingly with the United States at the expense of our other partners.<sup>14</sup> Thus, the Framework Agreement has neither improved the relationship with the EC as it was intended, nor has it even served as a bulwark against increasing dependence on trade with the United States.

Recently, however, the trends of Canada-EC trade have reversed. Beginning in 1984 Canadian trade generally began to grow rapidly, and our trade with the EC grew faster than the average. This was not, however, the result of the Framework Agreement functioning as it should, nor of the Canadian government addressing the question of the EC trading relationship. Rather, Canadian trade benefited from favourable exchange rate trends, which drove our total trade volume up, particularly with the countries of the EC.<sup>15</sup> However, this seeming improvement served to highlight the underlying weaknesses of the structure of this trade for Canada.

Canada suffers a structural trading disadvantage with the European Community. Canada's export strengths are her resource commodities. Thus a large proportion of Canada's exports to the EC are raw and fabricated materials. The EC, on the other hand, is strong in finished products, and so a majority of their exports to Canada are end products.<sup>16</sup> As Papadopoulos has noted, 'This results in a lop-sided trade composition which is unfavourable to Canada, since it exports more resources to, and imports more end products from, the EC.'<sup>17</sup> As our trade has grown, this inequitable trade composition has been revealed in the shifting balance of trade. As the volume of trade increased, the higher priced end products that the EC exports to Canada began to outweigh the value of our lower priced exports. Thus in 1985, for the first time, Canada faced a trade deficit with the EC.

Given that Canada considers it important to improve its exports of finished products, and thereby to escape its traditional role of resource supplier for the world, it is important to keep this profile in mind as the discussion turns to consider the future of our trading relationship with the EC. Once the potential impact of 1992 has been considered, it will be necessary to ask whether or not a trade relationship that seems rather detrimental to Canada's interests is worth pursuing.

A discussion of the Canada-EC trade would not be complete without some examination of the so-called trade irritants. In recent years the relationship between Canada and the Community has been plagued by a series of disagreements over specific areas of trade and commercial policy. A number of these are relatively minor, although they have proved remarkably intractable. The best known example is the EC ban on the importation of Canadian seal-skin products. While it affected a very few Canadian fishermen, they were fishermen in a depressed part of the country, and the issue acquired considerable political salience. Currently, the most serious of the irritants involves Community fishing off the coast of Newfoundland. The issue was close to a resolution, as the two sides concluded a Fisheries agreement in 1981; however, it has since become heated again, as after the agreement was signed Spain and Portugal joined the EC, introducing two of the worst violators of Canadian quotas into the relationship.<sup>18</sup>

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<sup>13</sup> Papadopoulos, *Canada*, 58.

<sup>14</sup> From 1970 to 1985 the percentage of Canada's exports that were sent to the United States jumped from 65% to 78%, while that of its imports from the United States remained essentially unchanged at 71%. [Derived from Government of Canada, *Canada's Trade Statistics*, 2<sup>nd</sup> ed., (Ottawa: Supply and Services, 1987), B.2.01.]

<sup>15</sup> Department of External Affairs, *Annual Report 1987/88*, (Ottawa: Minister of Supply and Services, 1988), 6-8, 37.

<sup>16</sup> While materials pass through a large number of value-adding stages in a typical manufacturing process, trade statistics generally divide goods into these three categories. Raw materials are essentially unprocessed resources, fabricated goods are those materials that have been put into usable form, but have not yet been used to build anything, and end products are the finished good at the end of the manufacturing cycle. Clearly, as a good moves up the list, the value added increases.

<sup>17</sup> Papadopoulos, *Canada*, 72.

<sup>18</sup> These are but two of a series of minor irritants, applying to a variety of commodities ranging from Cheddar cheese to newsprint on the Canadian side, and uranium and foreign investment on the Community's. A list of the irritants can be found in Papadopoulos, *Canada*, 70-71, although his discussion does not include the recent revival of the fishing dispute.

The single most important trade dispute between the two trading partners involves the most controversial and troublesome aspect of the Community's economic policy: the Common Agricultural Policy (CAP). The CAP was central to the original establishment of the EC, and is still the principal focus of the EC, absorbing roughly 60% of the Community budget! It has also proved remarkably resilient in the face of opposition both from the EC's trading partners (primarily the United States), and from its members (notably the United Kingdom). The CAP was designed, first and foremost, to secure agricultural supply for the Community, while at the same time providing a secure income for farmers. In order to do this, a variety of protectionist measures and a complicated pricing mechanism were established.<sup>19</sup> It is these measures which the EC's trading partners have claimed are trade distortions.

Because of the importance of agriculture to Canadian trade, the CAP has had a pronounced effect on Canada. From 1966 to 1984 agricultural exports as a proportion of Canada's total exports to the EC dropped from 23% to 11%; while our total exports increased by nearly four times in constant dollars, our agricultural exports did not even double.<sup>20</sup> Thus, Canada has joined with the United States in demanding CAP reform at the GATT negotiations. However, the resolution of the conflict is not proving easy to reach. It was the question of agricultural subsidies that led to the impasse at the pre-GATT meetings in Montreal, and as recently as July 8, 1989 *The Economist* was able to say:

Dwight Eisenhower could not have been more wrong when he said: 'Farming looks mighty easy when your plough is a pen and you're thousands of miles from a corn field.' As the pen pushers in the Uruguay round of GATT trade talks have learnt, negotiating on world agriculture is next to impossible. They produced deadlock last December, when trade ministers from 96 countries met in Montreal, followed by a reconciliation on style, but not on substance in Geneva in April.<sup>21</sup>

The signals coming from the EC are that they are willing to reform the CAP, and in fact they are doing so as part of the 1992 project,<sup>22</sup> but that the full freeing of international agricultural trade, if such a thing is in fact possible, depends upon agreement in the GATT.<sup>23</sup> That is, the Europeans are only willing to meet the concerns of the other trading nations (primarily the United States), if the questions can be satisfactorily resolved for all sides. Thus the key to liberalising agricultural trade remains reaching an accommodation between the US and the EC. Complicating this problem is that the US is not only concerned with the EC's protectionist agricultural policy, but also with access controls on the Japanese market. In order to have a fruitful conclusion to the Uruguay Round GATT discussions on agriculture, it becomes necessary not only for the US and the EC to resolve their differences, but for the US and Japan to resolve their's as well. Thus the benefits that Canada can expect to receive from the CAP reforms are contingent upon the agreement of the US, Japan and the EC. This puts Canada in an all too familiar position: its all-important agricultural trade is being, in effect, held hostage to the disagreements of the three major international powers.

What then emerge as Canada's expectations for its future trading relationship with the European Community? Clearly, from what the government, through Mr. Crosbie has said, improving Canada's competitiveness in high-end industrial exports is a priority. In the following consideration of the potential impact of project 1992, it becomes clear that this competitiveness is likely to be adversely affected. Interestingly, it would seem that, beyond informing Canadian producers of the changes in Europe, the government is doing very little to improve Canada's competitive position in response.

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<sup>19</sup> Overviews of the CAP can be found in Kerr, *The Common Market*, Chapter 5, 79-87; Commission of the European Communities, 'Europe's Common Agricultural Policy,' *European File*, 2/86 January 1986; and John S. Marsh and Pamela J. Swanney, 'The Common Agricultural Policy,' in Juliet Lodge ed., *Institutions and Policies of the European Community*, (New York: St. Martin's Press), 1983.

<sup>20</sup> Papadopoulos, *Canada*, 65.

<sup>21</sup> 'A GATTling Gun for Farms,' *The Economist*, July 8 1989, 15-16.

<sup>22</sup> For an overview of the CAP reforms, see Jacques Delors, 'Programme of the Commission for 1987,' *Bulletin of the European Communities*, Supplement 1/87, February 18 1987, 11.

<sup>23</sup> M. Jacques Delors, President of the Commission of the EC, in his programme for 1988, notes that the CAP is to be reformed in a number of ways, emphasising the maintenance of the tradition of European family farms and (more important for international concerns) adjusting output to market demands. The reforms, however, are predicated on reciprocal arrangements with other agricultural exporters in the context of the GATT. Jacques Delors, *Programme of the Commission for 1988*, Bulletin of the European Communities, Supplement, 1/88, Commission of the European Communities, 1988, 19.

The focus of what proactive Canadian efforts there are, is the maintenance of free access to the European market. Trade Minister Crosbie addressed this concern to the World Economic Forum in January 1989:

We are confident that Europe will remain open and contribute positively to the establishment of new rules and disciplines in the Uruguay Round that will lead to a more open, dynamic world economy. European integration must not lead to new trade barriers. That would be a blow to an open international trading system. Even the threat of new barriers could have a chilling effect on international trade and investment and on progress in the Multilateral Trade Negotiations.<sup>24</sup>

Canada's concern is that 1992 will see the emergence of 'fortress Europe,' as the market completion is used as an excuse to raise further barriers;

Although we recognise that the completion of the single market is essentially an internal process, transparency and ongoing dialogue between the EC, its member states and its external trading partners will serve to avoid uncertainty about the possible engineering of trade barriers as a result of 1992.<sup>25</sup>

The efforts to maintain open access have been directed mainly at the GATT negotiations, and thus have concerned themselves with the question of agricultural reform. Therefore, Canada's final goal is the completion of the Uruguay round of the GATT, having found a resolution for the problems of European agricultural subsidies and having initiated a new round of trade liberalisation measures.

These, then, are the goals to keep in mind as the programme to complete the European internal market is discussed, and an assessment is made of the likely impact that it will have on Canada's trading relationship with the Community.

## 1992: Plans, Progress And Prognostications

Spurred by the realisation that the European economy was steadily losing ground to those of both the United States and Japan, and by the resurgent demands of the European Parliament (EP) for completing the project of the Treaty of Rome by instituting Union, the countries of the EC committed themselves to the completion of the internal market by the Single European Act of 1987.<sup>26</sup> The internal market completion was conceived as fulfilling the principal goal of the original Treaty of Rome. While the original Treaty had established a customs union in name, and had transferred the control of trade policy to the Community in Brussels, there were still tremendous obstacles to the internal movement of goods, services, capital and labour. These non-tariff barriers to complete market integration were the target of the White Paper which preceded the SEA:

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<sup>24</sup> John Crosbie, 'Notes for and Address by the Minister of International Trade John C. Crosbie at the Annual Meeting of the World Economic Forum,' *Statement: Minister for International Trade*, 89/05, January 28, 1989, 3.

<sup>25</sup> John Crosbie, 'Notes for an Address by the Minister for International Trade John C. Crosbie at the Canada-United Kingdom Chamber of Commerce,' *Statement: Minister for International Trade*, 89/07, February 3, 1989, 10.

<sup>26</sup> The fear of international competition, particularly in the high technology sectors is the generally advanced explanation of the move to complete the single European market. See, among others, Pierre-Henri Laurent, 'The European Community: Twelve Becoming One,' *Current History*, 87 (532) November 1988, 357. This impetus may be inferred from the programme adopted by Commission and Council that led eventually to the provisions of the SEA, as it 'laid particular emphasis on ... action to achieve a single market by 1992 thereby creating a more favourable environment for stimulating enterprise, competition and trade.' From the 'Programme of the Commission for 1985,' quoted in, Commission of the European Communities, 'Completing the Internal Market,' White Paper from the Commission to the European Council, European Communities, 1985, 4.

The EP provided the catalyst with the publication of its 'Draft Treaty on European Union.' This followed the first direct elections to the Parliament in 1981. While there was not the needed support among the members' states for proceeding with Union, some response to the Draft was required. The process initiated by the Council in response to the EP's Draft Treaty resulted in 1985 in a White Paper from the Commission entitled, 'Completing the Internal Market.' By this time the EP had held its second set of direct elections, and had discovered that it did not have the confidence of the European publics. However, the White Paper had developed a certain political momentum, and by 1987 it had been codified in the SEA, and passed by the governments of all the member states.

The Treaty clearly envisaged from the outset the creation of a single integrated market free of restrictions on the movement of goods; the abolition of obstacles to the free movement of persons, services and capital; the institution of a system of ensuring that competition in the common market is not distorted; the approximation of laws as required for the proper functioning of the common market; and the approximation of indirect taxation in the interest of the common market.<sup>27</sup>

Thus the SEA committed the member states to a timetabled programme designed to 'eliminate by December 31, 1992, all the hurdles that denied the existence of a true Common Market.'<sup>28</sup>

The original programme that was adopted by the Council outlined 300 specific measures that were needed to complete the market, and a timetable to achieve the goals by the end of 1992. While the programme involved this plethora of specific proposals, covering a wide range of policy areas, these proposals were grouped in the White Paper into three categories: removal of physical, of fiscal and of technical barriers. While the categorisation is in large measure arbitrary,<sup>29</sup> the divisions are useful, and are now generally used in considering the progress of the programme.

The removal of physical barriers involves the dismantling of the procedures involved in crossing borders within the EC. This has been seen as a particular priority in the move to a single market for a number of reasons. As the White Paper made clear:

It is the physical barriers at the customs posts, the immigration controls, the passports, the occasional search of personal baggage, which to the ordinary citizen are the obvious manifestation of the continued division of the Community -- not the 'broader and deeper Community' envisaged by the original Treaties but a Community still divided. These barriers are equally important to trade and industry, commerce and business. They impose an unnecessary burden on industry flowing from the delays, formalities, transport and handling charges, thus adding to the costs and damaging competitiveness.

There is therefore a double reason for removing the physical barriers -- an economic reason and a political reason.<sup>30</sup> The goal was not to simplify the procedures, but to remove them completely. Once the programme is complete, as planned on the first of January 1993, there will be no border controls of any kind within Europe. Entering Britain or France from Belgium or Denmark should be no different from entering Norfolk from Suffolk, or New Brunswick from Nova Scotia.<sup>31</sup>

The removal of border controls immediately raises the question of the Value Added Taxes (VAT): 'Customs posts are above all a matter of tax.'<sup>32</sup> All European countries collect a substantial portion of their revenue from VAT, but the rates and how they are applied vary. There are commonly three VAT rates, a standard rate, a reduced rate for certain necessary goods (food usually falls within this category), and a high rate for luxury items. Not all countries have all three rates, some have ranges within a given category of rates,<sup>33</sup> and no two countries have the same set of rates. The reduced rate, where it is applied, varies from 0% to 10%, the high rate, in those six countries which use it, varies from 25% to 38% and the standard rate ranges from 12% to 25%. Clearly such a hodgepodge of tax structures imposes considerable restrictions on the free movement of goods.<sup>34</sup>

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<sup>27</sup> Commission of the European Communities, 'Completing the Internal Market: White Paper for the Commission to the European Council,' *European Council*, 1985, 4. It is interesting that, while in both the White Paper and the SEA the term 'Common Market' is used, it almost never appears subsequently in the discussions of 1992. When the project is referred to, it is the completion of the internal market or of the single market that is discussed. I have seen no explanation of this change but can only assume that the prevalence of the label 'Common Market' for the EEC and the EC has led to some troubling political connotations, and so the term has been dropped in favour of the new ones.

<sup>28</sup> Laurent, 'Twelve Becoming One,' 357.

<sup>29</sup> In fact, the third division is not really a category at all. Physical and fiscal barriers were reasonably easy to recognise as such, and so were grouped together. The rest of the measures were lumped into a heterogeneous category labelled 'technical' simply for convenience. Even the division between physical and fiscal is not always easy to see, however. The principal concern of the measures designed to remove physical barriers is that the border crossings are dismantled. However, the primary function of the border crossings is to collect the tax revenue that the states believe is rightfully theirs. The differing tax structure across the Community, which makes such collection necessary, is the principal concern of the measures designed to remove fiscal barriers.

<sup>30</sup> European Commission, 'White Paper,' 9.

<sup>31</sup> Those who have done it know that entering New Brunswick from Nova Scotia is not always easy. However, this is because the border is infested with tourist information booths, and tourists with large trailers on their cars insist on making life miserable for other drivers. Even the Single European Act could not hope to address these sorts of delays!

<sup>32</sup> 'Survey: Europe's Internal Market,' *The Economist*, July 9 1988, 8.

<sup>33</sup> For example, West Germany has a reduced rate of 7%, whereas Denmark does not have a reduced rate -- everything is charged at the standard rate of 22% -- and Ireland does have a reduced rate, but it varies from 2.4% to 10%.

<sup>34</sup> In addition to the obvious problems associated with the varying prices of goods in different parts of a single market, there are hidden costs imposed on business. In the comprehensive study of the benefits of the single market that the EC commissioned, Paolo Cecchini notes that business is not only faced with considerable accounting costs in order to comply with the tax variations, but also has additional red tape piled on because of the suspicions of tax inspectors. The governments feel that any intra-firm movement of goods is simply an excuse to dodge the VAT. This imposes considerable administrative costs on the company, and prevents them from acting



In order to address the problems of the VAT, the second section of the White Paper sets out measures to harmonise the VAT rates across Europe, and establish a system whereby the right governments get the right VAT revenue.<sup>35</sup> The Commission originally proposed two rates, a standard and a reduced rate, with the former ranging between 14% and 20% and the latter between 4% and 9%. These ranges, it was felt, would be bearable by a market with the limited geographical extension of Europe.<sup>36</sup>

The final element of the programme calls for the removal of technical barriers. While there is no common theme to the measures covered by the term 'technical barriers',<sup>37</sup> the White Paper did introduce a new norm for the facilitation of their removal. Before the passage of the SEA, in order for regulated goods, services or persons to move freely across the borders of Europe, the Community would have to harmonise the rules that governed their use in various states. Thus, national standards had to be abandoned in favour of a new Community standard. It is easy to foresee the problems this would raise. In order to accomplish completely free movement within the Community, the number of rules that would need to be harmonised would be truly prohibitive. However, the Commission proposed, and the member states accepted, a different principle to bypass the problem, the principle of mutual recognition:

Goods and people moving within the Community should not find obstacles inside the different Member States as opposed to meeting them at the border.

This does not mean that there should be the same rules everywhere, but that goods as well as citizens and companies should be able to move freely within the Community.... [T]he general principle should be approved that, *if a product is lawfully manufactured and marketed in one Member State, there is no reason why it should not be sold freely throughout the Community.* [Emphasis added]<sup>38</sup>

As would be expected, the use of mutual recognition in place of Community harmonisation has facilitated the progress of the measures designed to remove the technical barriers to trade.<sup>39</sup>

The one other element of the SEA that deserves mention is a second procedural change designed to facilitate the implementation of the 1992 directives. For all but a few areas relating to the completion of the internal market, the European Council is now able to approve EC legislation with a qualified majority vote instead of unanimity.<sup>40</sup> When it is remembered that the Council comprises twelve sovereign states, and that it must approve all of the 1992 directives, it becomes clear that any move away from unanimity will facilitate the decision-making process. Not surprisingly, this is exactly what is happening:

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as a single firm, rather than a collection of individual national firms. Paolo Cecchini, *The European Challenge 1992: The Benefits of a Single Market*, (Brussels: Commission of the EC, 1988), 32.

<sup>35</sup> For a technical discussion of the VAT problems of 1992, see P. Guieu and C. Bonnet, 'Completion of the Internal Market and Indirect Taxation,' *Journal of Common Market Studies*, 35 (3) 1987, 209-22.

<sup>36</sup> The question of geographical extension is crucial to this sort of problem. Canada, for example, can maintain widely differing tax rates from province to province because of the tremendous costs involved in moving people or products across the country. Europe has nothing like the same geographic buffer. Where Canada covers 10 million km<sup>2</sup>, the twelve countries of the EC comprise a mere 2 million km<sup>2</sup>. (From 'A Community of Twelve: Key Figures,' *European File*, 3-4/89 March 1989, 4.) The United States, with large land area, but small internal divisions, has found that the market dictates a tax spread of no more than five percent between neighbouring states. (*The Economist*, 'Survey,' 42.)

<sup>37</sup> The Section on technical barriers in the White Paper is further divided into seven subsections: 1. Free movement of goods, 2. Public procurement, 3. Free movement of labour and the professions, 4. Common market for services, 5. Capital movements, 6. Creation of suitable conditions for industrial cooperation, and 7. Application of community law. The only thing, it would seem, that these categories, rather vague in themselves, have in common with each other is that they are not physical or fiscal in nature.

<sup>38</sup> European Commission, 'White Paper,' 17.

<sup>39</sup> European Commission, 'Fourth Progress Report of the Commission to the Council and the European Parliament,' (Brussels: Commission of the European Communities, June 20 1989), 2.

<sup>40</sup> The majority is 'qualified' because it requires more than a simple majority of the states voting in order to approve a measure. In order to address the disparity in size among the members, different numbers of votes are accorded to different states. Anne Daltróp has explained the process of qualified majority voting:

A qualified majority is determined by giving each member state a specified number of votes: ten to each of the four largest states, the United Kingdom, France, West Germany and Italy; eight to Spain; five each to Belgium, Greece, the Netherlands and Portugal; three to Denmark and Ireland; and two to Luxembourg. Fifty-four votes out of the total of seventy-six constitute a majority. [Anne Daltróp, *Politics and the European Community*, 2<sup>nd</sup> ed., (London: Longmans, 1986), 15.]

Decision-making by the institutions has accelerated considerably since the Single European Act entered into force, primarily due to the changes in procedure. The extension of qualified majority voting to most issues connected with the internal market has stepped up the pressure to find a consensus within the Council. This faster pace has enabled the Council to have definitively adopted 127 measures representing -- together with current common positions and partial adoptions -- approval of over 50 per cent of the programme of 279.<sup>41</sup>

As this quotation from the Commission's report suggests, the programme to complete the internal market is progressing, but is far from complete. In order to assess the likely impact of the programme on Canada and Canadian trade, it is necessary to assess the progress that has been made, and identify problem areas. Only in this way can a reasonable approximation of the final result be derived, against which to judge the effects on external parties.

While the White Paper and the SEA set out a reasonably precise timetable for the implementation of the programme to complete the single market, the political problems raised by a number of the provisions has, not surprisingly, changed the implementation schedule. The unification of the European market involves a tremendous affront to the sovereignty of the member states, and as it is these members, sitting as the European Council, that must approve any directive before it is promulgated as Community law, conflicts and delays are predictable. Some of these conflicts are so deep and have seemed so intractable that people have questioned whether or not 1992 will produce a single European market at all. If by that question it is meant will the market in Europe appear exactly as envisioned in the SEA, the likely answer is no. However, the programme has developed a tremendous momentum, and will almost certainly result in a much more unified market than Europe has at present.<sup>42</sup> In order to see the shape of that final product it is necessary to look at the progress that has been made, and the changes that have been, or are likely to be, introduced.

The greatest progress to date has been seen in the implementation of the measures designed to remove technical barriers. This is, as was noted above, a large and heterogeneous group of measures aimed at a variety of hindrances to a single market. Most of the requisite decisions in this area may be taken by qualified majority voting in Council, and so have moved fairly well. This includes freeing the movement of capital, provision of banking and other financial services across the Community and harmonisation of rules in the areas in which mutual recognition is insufficient. In most of these areas the necessary directives are almost all in place.<sup>43</sup>

One particularly important area covered by the technical barrier segment of the programme is the freeing of government procurement. The EC estimates that procurement accounts for 9% of the Community's GDP (180 billion ECU or \$256 billion Cdn<sup>44</sup>), and that less than 20% conforms to the principles of a Community market.<sup>45</sup> Thus one goal of the 1992 project is the freeing of public procurement across the EC. This means that, in the areas covered by the programme,<sup>46</sup> there should be no barriers to *any* company based in *any* EC country supplying a contract to *any* government.<sup>47</sup> So far the directives that have been introduced to create a free procurement market have been adopted both by the Council and the member states' legislatures,<sup>48</sup> and the Council is

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<sup>41</sup> European Commission, 'Fourth Report,' 2. The 279 figure is the number to which the original 300 measures have now been reduced.

<sup>42</sup> This is certainly the view of the Community institutions. They argue that even if the work is not complete by the end of 1992, the progress is irreversible, and the European market will be completed. See 'A Europe Without Frontiers: Answers to some Questions,' *EC News*, (Ottawa: Delegation of the Commission of the EC, October 1988), 5.

<sup>43</sup> European Commission, 'Fourth Report,' 15-26. The SEA requires the Commission to produce for the EP and Council an annual report on the progress of the 1992 programme. This report details the measures that have been passed, the measures that have needed to be amended to gain Council approval, and the areas that are causing problems. The most recent of these reports, the Fourth, was released June 20, 1989, and it is from this report that the bulk of my assessment of the progress of 1992 is drawn. For a detailed list of the status of the directives for the completion of the internal market, refer to the Annexes of this report. These three Annexes list, in order: the proposals that have been adopted; those presented by the Commission but not adopted by the Council; and those yet to be presented, with the timetable for adoption.

<sup>44</sup> The Canadian dollar value was obtained by converting based on an exchange rate of 1 ECU = 1.42 \$Cdn, which was the rate to two decimal places as of noon, March 8, 1990, as reported in the *Globe and Mail*, March 9, 1990, B13.

<sup>45</sup> 'Opening Up Public Procurement in the European Community,' *European File*, 1/89 January 1989, 3. The procurement problem presents an interesting example of the competitive advantages that the Community hopes to achieve from 1992: 'The European Commission estimates that the cost of the waste and lack of competition resulting from the fragmentation of public procurement in the Community is some ECU 20 billion per year -- equivalent to approximately half of the entire Community budget.'

<sup>46</sup> It is worth noting that, at present, at least, defence contracts are not subject to the provisions completing the market in government procurement.

<sup>47</sup> The project calls for the extension of the rules governing free procurement into areas previously exempt from Community procurement rules. These areas include telecommunications, transport, drinking water and energy. What it does not include is Defence materials. *European File*, 'Opening up of Public Procurement,' 9.

<sup>48</sup> The exceptions to the latter are Greece, Spain and Portugal, which have been allowed to delay implementation until March 1 1992.

currently considering directives aimed at incorporating the new areas into the legislation.<sup>49</sup> For Canadian firms this is relevant in two ways. It means that firms that are established anywhere in the EC will be able to compete for procurement contracts across the Community. In addition, Canadian firms that are competitive in sectors that service procurement contracts, but which are not established in the EC, might now do well to consider becoming established there, as they need base themselves in only one country rather than twelve. Of particular relevance to Canada is the inclusion of telecommunications in the areas covered by the procurement rules, as this is a sector in which Canada is traditionally strong.

Canadian firms operating in Europe need also to pay attention to the so-called 'social dimension' of 1992. This is a particularly troubling political question within the Community, as Britain's Prime Minister Thatcher is unalterably opposed to the introduction of 'socialist' measures at the Community level. The measure that Thatcher most opposes is the measure of greatest concern to external firms operating in the EC: the proposed European Companies Statute. The Statute would require companies operating within the EC to adopt some form of worker participation in the management of the operation.<sup>50</sup> This would clearly impose some costs on Canadian firms establishing themselves in the EC, as worker participation is not common in this country. Whether or not the Statute will be adopted is still unclear. However, Thatcher is alone in her opposition to it, and the other states seem willing to use Council majority voting to pass it over her head. The question is whether the other states will be willing to antagonise Britain even further for the sake of the Statute, although at present the answer appears to be yes.<sup>51</sup>

The two areas which are causing the most problems are the removal of fiscal (tax) and physical barriers. Both of these involve important political effects, and both require unanimity on the Council for passage. As noted above, the original Commission proposal for the VAT was the harmonisation of VAT rates around two, five-percent bands. This produced a political deadlock, mainly because the proposals satisfied neither the high nor the low taxing states.<sup>52</sup> However, recently the deadlock has been broken as the Commission has amended its position to accommodate the dissenting states. In place of the ranges, minimum rates for the low and standard rates will be established, with the zero rate retained for those states which wish to apply it, and the no rate ceilings will be specified.<sup>53</sup> This will allow states to tax as the market will bear, which, as suggested above, is likely to be no more than five-percent. The Commission believes that this new approach to the VAT will permit the question of indirect taxation to be resolved, despite the lack of progress to date:

The Commission's new approach fully respects the objectives of fiscal approximation laid down in 1987, while introducing a greater degree of pragmatism and flexibility into the discussion. It should enable the Council to make rapid and substantial progress with this essential element of the internal market programme, thus ensuring that early agreement can be reached on implementing the measures of alignment envisaged for the transitional phase.<sup>54</sup>

This breakthrough suggests that what was seen as one of the most unlikely elements of the programme to succeed will be in place by 1993, and thus firms selling across the European market can expect roughly harmonious VAT impositions on their products.

At the end of 1988 *The Economist* was able to write: 'By the end of 1992, according to the European Community's brave plan for a frontier-free internal market, border controls between EEC countries are supposed to disappear. They won't.'<sup>55</sup> There is little

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<sup>49</sup> European Commission, 'Fourth Report,' 18.

<sup>50</sup> 'Require' is something of a misnomer. The Statute would only require compliance of those firms that chose to adopt it. However, there are intended to be strong tax incentives to encourage adoption, and so its seemingly voluntary character is somewhat illusory -- or so Mrs. Thatcher argues.

<sup>51</sup> See 'EEC Social Policy: The Passionate Dimension,' *The Economist*, April 8 1989, 56, and 'EEC's Social Dimension: Louder than Words,' *The Economist*, July 8 1989, 38.

<sup>52</sup> The principal opponents were the UK and Ireland, both of which have a low VAT rate of 0% on certain items, mainly food, a rate which they are determined to maintain.

<sup>53</sup> European Commission, 'Fourth Report,' 25.

<sup>54</sup> European Commission, 'Fourth Report,' 26. The 'transitional phase' is the period between now and the end of 1992 in which the member states are supposed to make substantial progress in aligning their VAT rates with the requirements of the internal market directives.

<sup>55</sup> 'Frontier-free Europe: Plenty to Declare,' *The Economist*, December 24 1988, 57.

reason, at present, to think that its prediction will be proved wrong. The Commission reports that: 'Although most of the proposals to abolish frontier formalities are now on the table, the Council has yet to adopt any major decision on them.... [and] no specific measures have yet provided tangible evidence of the political will to abolish frontier inspections.'<sup>56</sup> Once again Mrs Thatcher is the principal stumbling block. She is concerned with the movement of illegal immigrants across Europe, and with the movement of such contraband as guns and drugs.<sup>57</sup> In this case, Britain is not isolated, as other members are beginning to reflect some of her concerns. Thus it would seem likely that while most commercial controls will be removed by the end of 1992,<sup>58</sup> Europe will not be free of internal frontiers.

The controls that do remain in place will be directed at restricting, at least to a degree, the movement of people. This is the final area of the programme that is meeting some resistance. The goal of the internal market completion is that any economic activity can be performed by any member of the EC in any country of the EC.<sup>59</sup> This means that goods, capital *and* labour must be free to move. The restrictions on the first two are being removed, but progress on the last one is mixed. The directives designed to ensure the freedom of professionals to provide their services across borders have been adopted, or seem to have clear passage. However, the free movement of wage-earners, while essential to the full completion of the market, is unlikely to be realised:

The current restriction on the right of residence to persons in employment is out of keeping with the image which the Community must project to its citizens. However, the Council's unsuccessful negotiations on the proposal for a general right of residence revealed a lack of will on the part of the Member States unanimously to introduce such a right. For this reason, rather than seek a compromise which might have watered down the right of residence, the Commission chose to withdraw its proposal and announce new ones to grant the right of residence to students and retired persons [ie persons who are not members of the labour force] by majority vote.<sup>60</sup>

Given this progress, and the identifiable problem areas, what is the likely result of the 1992 project? There would seem no reason to disagree with the Commission's own assessment, that the momentum of 1992 is such that it cannot be stopped. Margaret Thatcher stands as the project's biggest obstacle, but even she has recently been softening her position, and has been facilitating movement on elements of M. Delors' programme to which she had appeared unalterably opposed.<sup>61</sup> Her opposition is being tempered by clear political signals within Britain that her anti-Europeanism is unpopular, and so the ever-pragmatic politician is altering her strategy in order to save her political life.<sup>62</sup>

Thus, by the end of 1992, the European market will be more unified than it has ever been. However, it will almost certainly not fully meet the goals of the Commission's original proposals. The borders will probably not be down completely, labour will almost certainly not be free to move across Europe as it pleases, despite the freedom of capital and professionals, and the 'social dimension' is likely to remain incomplete. Despite these contradictions, the European market will be essentially complete by the beginning of 1993. The question this now poses is what will be the economic effect of this all-but-complete internal market in Europe? There are two sides to this question. The first is the effect on the European economy, and the second is the effect on the Community's relations with the outside.

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<sup>56</sup> European Commission, 'Fourth Report,' 3.

<sup>57</sup> This is a less idle concern than many of hers. The constitution of the Federal Republic of Germany permits almost unlimited access to the FRG on the basis of refugee claims. In a Europe without borders, once in the FRG a fraudulent claimant would be difficult to prevent from moving across Europe. This is where Mrs. Thatcher is gaining some support, as the other member governments look at the possibility of Turkish migrant workers, for example, streaming into their country from the FRG.

<sup>58</sup> The Commission's report suggests that most of the commercial controls are well on their way to being abolished and that there is no reason to expect that this portion of the programme will not be completed on schedule. European Commission, 'Fourth Report,' 11-14.

<sup>59</sup> For a discussion of the EC's history of labour mobility, see Thomas Straubhaar, 'International Labour Migration Within a Common Market: Some aspects of EC experience,' *Journal of Common Market Studies*, 37 (1) 1988, 45-62.

<sup>60</sup> European Commission, 'Fourth Report,' 20.

<sup>61</sup> The obvious example is the movement of Economic and Monetary Union (EMU). This is not a direct element of the SEA or of the 1992 project, but most realise that a truly common market needs a single currency. The EMU is an idea that Thatcher has repeatedly denounced. However, at the Madrid Council in June of 1989 she agreed to the first stage of the EMU, and committed Britain to participate in a conference called to examine the subsequent steps. See 'The Meaning of Madrid,' *The Economist*, July 1 1989, 37-38.

<sup>62</sup> The recent elections to the EP saw Thatcher's Conservatives lose their first national election since her accession to the leadership. This seems to have sparked a 'Europeanising' of Thatcher, similar to the 'Greening' she underwent, as it became clear that environmental issues were politically important.

The European Commission has commissioned a comprehensive study on the benefits to the European economy of completing the internal market. The essential finding of the study is that the market completion will have nearly universal positive effects once the adjustment period is overcome:

For all its complexities, the essential mechanism is simple. The starting point of the whole process of economic gain is the removal of non-tariff barriers.

The release of these constraints will trigger a supply-side shock to the Community economy as a whole. The name of the shock is European market integration. Costs will come down. Prices will follow as business, under pressure of new rivals on previously protected markets, is forced to develop fresh responses to a novel and permanently changing situation. Ever-present competition will ensure the completion of a self-sustaining virtuous circle. The downward pressure on prices will in turn stimulate demand, giving companies the opportunity to increase output, to exploit resources better and to scale them up for European, and global competition.<sup>65</sup>

These benefits will derive in large part from four specific consequences of the market completion: the availability of cost reductions from the economies of scale; improved efficiency from trans-European rationalisation of firms;<sup>64</sup> increased competition and competitive advantage; and increased pressure for innovation.<sup>65</sup> Thus the likely result of the 1992 programme is an increasingly competitive market, and increasingly competitive European firms.<sup>66</sup>

The question remains, however, of whether this increased competitiveness will be achieved at the expense of the international trading ties of the EC. Will, as some have feared, 1992 create a fortress Europe, impermeable to outside economies? There seems increasingly little basis for this fear. The Commission and the member states have repeatedly stressed that they require an open international trading system, and that they in no way intend the completion of the internal market to be an excuse for the reduction of international free trade.

[T]he European Council made its view clear on this matter at the Summit of Heads of Government at Rhodes in December 1988.

The European Council stated that the Internal Market will be beneficial to both EC companies and to non-Community firms, as both will no longer deal with national barriers, be they physical, technical or fiscal. The aim is to abolish barriers for all.

Furthermore, the economic growth expected from the completion of the Internal Market will have favourable economic consequences, both for the Community and for its trading partners ....

The Internal Market programme involves no weakening of the Community's commitment to respect its international obligations.

Where international commitments, whether multilateral or bilateral, exist, they will continue to be honoured.

In sectors where no multilateral rules exist, the Community will endeavour to develop, reinforce and enhance the multilateral system.<sup>67</sup>

The EC argues that the claims that it is protectionist (mainly stemming from the CAP) are unfair. As President Delors has noted, 'it must be underlined that the Community is, in fact, the most open trading unit in the world.'<sup>68</sup> This claim is based on the fact that the average tariff, applied centrally by the Community, is lower than Japan's and comparable to the tariffs of the United States,' while

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<sup>63</sup> Cecchini, 1992, xix. Unfortunately, Cecchini's work is the only comprehensive survey of the likely effects of the market completion that has yet been published. Thus it is necessary to base the assessment of the impact of 1992 on Canada on a single, liberal interpretation of the impact, one that was produced for the Commission, which has a vested interest in the project's success. It is worth noting, for example, that the report that the Ontario Ministry of Industry, Trade and Technology commissioned, also had to base its findings on Cecchini's study.

<sup>64</sup> European firms have already begun to respond to the rationalising imperatives of 1992. See, among others, 'Get Big' the Cry as 1992 Approaches,' *Financial Times* (London), November 21 1988; and Steven Greenhouse, 'Merger Mania Strikes Europe as Barrier-Free Market Nears,' *New York Times*, August 26 1988, A1.

<sup>65</sup> Cecchini, 1992, 73. The full discussion of the economics of these effects is found between pages 74 and 90 in Cecchini's study.

<sup>66</sup> This is the conclusion reached by the one study the government of Canada has released thus far on the effects of 1992. See Department of External Affairs, *1992 Implications of a Single European Market: Part 1: Effects on Europe*, (Ottawa: Minister of Supply and Services, 1989), 54-60.

<sup>67</sup> Jaques Lecompte, 'Europe 1992: The Completion of the Common Market,' *EC Newsletter*, 2/89 June 1989, 3.

<sup>68</sup> Delors, Jacques, *Programme of the Commission for 1987*, Bulletin of the European Communities, Supplement 1/87, February 18 1987, 10.

its rate range is smaller. In addition, the Community notes that its place as a large international trader means it has a vested interest in the maintenance of the liberal trading order.<sup>69</sup>

There are good reasons to believe these EC claims. To begin with, the reliance the Commission has shown on the Cecchini Report in planning for the effects of the market completion suggests strongly that the essential economic outlook in the Commission is liberal.<sup>70</sup> Secondly, the EC has rightly pointed out that in all the previous moves toward the market completion, liberal forces have won any resulting conflicts. Because of the ability to subvert non-liberal positions in an open market, conflicting interests have tended to be resolved at the most liberal position.<sup>71</sup> Thus, protectionist measures would almost certainly require unanimity at the Community level to be implemented, and the political mood in most governments, and certainly in Britain, is opposed to protectionism.

The final concern of the EC's trading partners is over its insistence on reciprocity. The EC has said that in order for external parties to provide financial services in the single market, EC institutions will have to be granted reciprocal privileges in the other party's country of origin.<sup>72</sup> This has caused considerable concern, particularly, for example, in the United States and Canada, which do not have free markets within their own countries for financial services. The fear has been that the EC will use this to deny external purveyors of financial services access to the European market. The Community has assured the outside that this is not their intention, but rather they are concerned only that EC finance has access to other markets if the EC is to be opened to external financial institutions. As yet, however, no formal directives have emerged, nor have any agreements been reached on how to resolve these questions.<sup>73</sup>

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<sup>69</sup> Willy De Clercq, 'Europe into the 1990s, *EC Newsletter*, 4/88 November 1988, 2-3. M. De Clercq is the EC's External Policy Commissioner.

<sup>70</sup> Consider the following from the introduction to Cecchini's *The European Challenge: 1992*, which follows directly the passage quoted above:

However, the effect of the [1992] shock is to be gauged not just in terms of the market, and of the companies and consumers who buy and sell there. Its waves will ripple out into the economy at large. By its very size the shock will have reverberations on general economic management. Over time, creation of a European home market will unbind the macro-economic constraints which have chronically fettered the prospects of sustained growth in Europe for the best part of twenty years.

Public deficits will be eased, under the dual impact of open public procurement and the economy's regeneration. Inflation, traditionally growth's ugly sister, will be pulled down by the drop in prices provoked by open markets. The jolt so imparted to Europe's competitiveness should ensure that growth is achieved without damage to the Community's external trade position.

But, perhaps most important of all, is the medium-term impact of market integration on employment. With its injection of inflation-free growth, coupled with a loosening of the constraints on public exchequers in the Community's member states, the European home market of the 1990s raises the prospect, for the first time since the early 1970s, of very substantial job creation. The added elbow-room given to governments should, in addition, enable any unevenness in the rewards distributed by market integration to be compensated.

1992 is seen as the liberal utopia. It promotes growth, without causing any of the traditional negative side effects of growth. It attacks everybody's favourite economic target, the deficits. It benefits producer, consumer and worker (by providing increased work opportunities). And it allows for the regional inequalities of Europe to be addressed, again for free. Yet, it is the liberals who have taught for years that there is no such thing as a free lunch. Who is paying for the *laissez-faire* utopia? How can such a profound change bring only benefit and no cost? If this were possible, why has it taken so long, and why is it not universally hailed even now that it is imminent? The answers lie in part in a broadening of scope.

The benefits that the liberal traders see are all economic, and their focus is very closely economic. However, a good number of the costs are political. The competition of the single market requires that states surrender a great deal of their sovereignty (Mrs. Thatcher's central complaint), so that in return for the lower deficits and greater economic well-being of their citizens the state must trade itself. These observations suggest, if there is still any doubt, that politics and economics simply cannot be treated separately. In discussing the economy, politics must be considered. By limiting the focus to the European economy, it is possible to suggest that the Market completion is cost free. This neglects the fact that the economy is an open system, and the costs are being exported to the political side of the political-economy of Europe.

This is not necessarily a bad thing, but it is a cost, and needs to be addressed, particularly if the chances for 1992's success are to be assessed. As well, as the powers of the national governments erode, so does the protection afforded to the workers. Large business will gain immense freedom from state interference in the market completion (which is one more reason the liberals like it), as individual states will have less ability to impose their will upon the enterprises. This means that the social controls that states have imposed for the protection of labour will be removed at the national level. If they are to be reintroduced, it will have to be at the Community level, and as yet, the Community is not nearly powerful enough to do so.

<sup>71</sup> European Commission, 'Improving Competitiveness and Industrial Structures in the Community', *Document*, 1987, 4.

<sup>72</sup> External Affairs, *1992 Implications*, 115-16.

<sup>73</sup> External Affairs, *1992 Implications*, 62.

Thus it seems likely that the post-1992 EC will be at least as open as it is at present to foreign economic interests, and probably more so. The focus, however, of all the EC's efforts for international trade liberalisation is the Uruguay Round of the GATT. They are intent on expanding the GATT into new areas, including intellectual property and services.<sup>74</sup> However, the principal issue of the GATT Round for the EC is the question of agriculture. Although no one is discussing the possibility, it is not too great an imaginative leap to suppose that the degree to which the EC will be willing to open its unified internal market will depend, in part at least, on the successful resolution of the agricultural dispute in the GATT.

## 1992 And Canadian Trade

Given that the likely conclusion of the 1992 project is a nearly-completed European market increasingly open to the outside, what are the prospects for Canada? It is reasonable, for once, to agree with Canada's Minister for International Trade, who said of 1992, 'it will create both risks and opportunities -- risks through more competition from stronger European firms; and opportunities as the European economy expands.'<sup>75</sup> The question that Canada must decide is how best to prepare to avoid the risks and capitalise on the opportunities.

It seems almost certain that the completion of the internal market will provide a competitive boost to the European firms. This threatens Canadian business in two ways. First of all, it means that Canadian firms will need to be more competitive in the European market if they are to enter or remain in it.<sup>76</sup> Papadopoulos has found that even in the incomplete European market Canadian firms tend to be outmatched, as they suffer from a number of competitive inefficiencies.<sup>77</sup> This is certainly supported by the increasing trade deficit Canada shows with the EC, which stems largely from an inequality of trade in manufactures. This is particularly troubling because of the emphasis that the Canadian government has placed on improving Canada's competitive position in high end goods. While this suggests that 1992 may act as a spur to prick the sides of Canadian industry, it also suggests that there is a lot of work to be done to be competitive in the new market.<sup>78</sup>

The second threat the increased competitiveness of European industry poses to Canada is competition in markets other than the EC's. The EC's competitive advantage will carry over into its trade relations with other countries. Of particular concern to Canada is the effect of this in the third world. A threat not only to Canada's second largest export market in the EC but also to the rest of its markets is worrying if Canada wishes to avoid having all its trade with the United States. In order to meet that threat, Canada must once more improve its competitiveness and, in addition, focus on the areas in which it may have competitive advantage. Put simply, an increased threat from competitive European firms will require vigilance and strategic planning on the part of Canadian business and government. Unfortunately, if Papadopoulos is to be believed, this is not one of Canada's strengths.<sup>79</sup>

The improved economic performance of the EC does provide a number of opportunities, however. The EC already imports a good proportion of its raw materials, with a not-insubstantial amount coming from Canada. As the EC's economy grows and increases its competitive efficiency, it will require ever-greater amounts of raw material to supply its needs. This suggests that Canada should find an increased market for its raw material exports after 1992. This is, however, a mixed blessing. While Canada is strong in commodity exports, a consistent theme of Canadian economic policy has been to move beyond being a material supplier to the

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<sup>74</sup> Delors, 'Programme for 1988,' 20.

<sup>75</sup> John Crosbie, 'Closing Address,' 4.

<sup>76</sup> This is recognised by a number of analyses. It is implied in Cecchini's work, and was made explicit in a recent publication of the Commission delegation in Ottawa, 'A Europe Without Borders by 1992: Answers to Some Questions,' Delegation of the Commission of the EC, 01/10/88, 3. It is also in both of the Government of Ontario's analyses of the impact of 1992. See 'Ontario Trade Review, 1988: Volume 2,' Standing Committee on Finance and Economic Affairs (SCOFEA), 1<sup>st</sup> Session, 34<sup>th</sup> Parliament, October 1988, 9, 23; and OMITT, 'Europe 1992,' 34.

<sup>77</sup> Papadopoulos, *Canada*, 83-110.

<sup>78</sup> This may be partially offset by the FTA. Most of the economic analysis suggests that the FTA will provide similar competitive benefit to Canadian firms that 1992 is providing to the European. This is not to neglect, however, that this form of analysis suffers the same political blindness as similar analyses of 1992. See note, 63 above.

<sup>79</sup> Papadopoulos, *Canada*, 91-98.

world. As noted above, the government hopes to improve Canada's industrial competitiveness, particularly in the high technology sectors that are increasingly dominating international trade in goods.

1992 does provide certain opportunities for just such improvements. One element of the programme is a \$10 billion research framework which the EC has established to improve its industrial technological capabilities. Once more this is both an opportunity and a risk for Canada. It is an opportunity because outside participation is permitted and in July 1988 Canada applied to be allowed to participate. It is also a risk, however, as it once more threatens to improve the competitive advantage of the Europeans who are aiming for the standards of the Japanese and Americans, and Canada is competitive in only a few sectors with these two giants.<sup>80</sup> If Canada is able to make use of this research programme, it presents an opportunity to improve its technological capabilities far beyond its own means could allow by tapping the resources of the huge European market.

It is not only in research that the single market in Europe presents opportunities for Canadian business to become more fully involved. An expanding European market will have more opportunities for entrance, for investment and for joint ventures. For example, the freeing of public procurement and the inclusion of telecommunications in the procurement package means that competitive Canadian companies, notably Northern Telecom, will have increased access to lucrative European markets. In addition, the freeing of capital flows and of the rules governing the provision of financial services may allow for greater participation of Canadian banks in providing financial services across the EC. As firms try to rationalise across the European market they are taking to entering into more and more joint ventures and collaborative agreements. Such arrangements may permit small firms to be successful in the large market in a way they could not be by themselves. Such a mechanism might well provide entrance into the European market for Canadian firms that have considered themselves too small to be able to expand overseas. These small firm will be able to find distributors for their products in Europe who can then sell them across the EC, where previously the Canadian firms were likely to need several EC connections to cover the whole Community. Partial coverage or multiple partnerships may well be beyond most small companies, where a single arrangement might well be manageable.

In fact, this is the largest single benefit of the new market for international as well as for European business. It will no longer be necessary to consider a plethora of national norms and regulations when trying to penetrate the EC market. This means that distribution of products or services for the whole Community can be centralised, and that the products or services themselves can be standardised across the Community. Whether it is necessary to meet a harmonised European standard, or a single national standard that is then recognised across the EC, it should be necessary to meet only one standard for the twelve countries,<sup>81</sup> which should serve to make the European market more accessible and thus more attractive to Canadian business.

Keeping in mind the government's twin priorities of maintaining access to the three emerging regional markets and improving Canadian competitiveness, particularly in the high end industrial and technological sectors, how should Canada respond to these varied challenges of 1992? In terms of maintaining market access, the government appears to be on the right, in fact the only possible, track. Canada must continue its diplomatic efforts, both bilaterally with the EC and in the Uruguay round of the GATT, aimed at ensuring the maintenance of an increasingly liberal international trading order.<sup>82</sup> The GATT round, in fact, presents an opportunity for Canada to exercise its famed skill at diplomatic intermediation. There would appear to be some room for movement in the principal dispute over agricultural protection,<sup>83</sup> and so there might be an opportunity for Canada to shepherd this to a resolution of the dispute. Such a resolution is a precondition of a successful GATT negotiation in Uruguay, and as such is a precondition for achieving reasonable security of access to the European market.

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<sup>80</sup> SCOFEA, 'Ontario Trade Review', 9. The terms of participation are that the participating firm have research facilities within the EC, although joint ventures are permitted.

<sup>81</sup> De Clercq, 'Europe into the 1990s', 2-3.

<sup>82</sup> This assumes that an essentially open international trading system is the best international arrangement for Canadian interests. This is by no means a certainty. However, it is the assumption of this government, and has been of most previous Canadian governments since the second world war, and this is not the place to enter into the debate over the ideal form of the international political economy.

<sup>83</sup> See *The Economist*, 'GATTling Gun', 15-16.



The more troubling problem is how to address Canada's slipping competitiveness and, in fact, how improve the competitiveness of our high-end producers. It is clear that the international economy is becoming more competitive, and 1992 will only heighten that effect. Thus, regardless of the results of 1992, Canada will face a more competitive environment in the coming decade -- if for no other reason than the entering into force of the FTA. 1992 must thus be seen as part of a changing environment that will require increased competitive capability from Canadian companies, and will therefore also require strategic decisions to be made now. Given these imperatives, there would seem to be two approaches to the opportunities and challenges presented by Europe 1992.

The first is the strategy that the Canadian government seems to want to follow, and that the Ontario government studies have suggested, but to which the federal government has seemed unable to commit itself. This strategy is designed to maintain, or perhaps expand, Canadian trade with the EC, which involves preparing Canadian business to meet the specific challenges of the European market. In particular it means an across-the-board effort to improve Canadian competitiveness.<sup>84</sup> One central element of such a commitment would necessarily be a substantial research and development effort. While part of this effort could be conducted in concert with Europeans through the framework research and development programme, this, by itself, will be insufficient. Even to bring Canada to the leading edge of industrial technology in today's environment would require a large research investment within Canada; to meet the challenges of the post-1992 international market will require much more.

While this strategy requires that such measures be taken in Canada, the European market must itself be used to accomplish the strategy's goals. As the 1992 programme unfolds, there will be increasing numbers of specific opportunities for increased market access, for market entry in wholly new areas, and for joint ventures with a variety of European firms. In order to make this first strategy work, these opportunities need to be seized -- all of them. Canada's deteriorating competitiveness and the increasing proportion resource exports make of its trade with the EC, suggest that Canada cannot miss any opportunities that the market completion programme might present, if it is to be competitive within the completed internal market. For this, the government's present strategy is insufficient. As the Ontario Ministry report notes (see above, page 4), the government is attempting to monitor the 1992 changes in order to make the most of these opportunities, but its approach is not large enough nor aggressive enough to meet those opportunities as they arise. Thus, in order to fulfil the requirements of the strategy the government seems to have adopted, a greater commitment is needed. This commitment must take the form of an improved research and development programme, and a larger and more aggressive campaign to alert business to the opportunities opening in the European market, and help them gain access to it.

It is obvious that this is an expensive strategy, requiring a considerable commitment from the federal government. It is not the only strategy possible, however, to address the challenges that Canada faces. The watch-word of the new international economy is 'rationalisation.' The FTA has been sold by the government for the economic benefits of rationalising for the North American market, and a good number of the benefits to the European economy from 1992 that Cecchini outlines derive from the increased ability to rationalise across the European market.

The second possibility then is to rationalise Canadian business for a definite niche in the other two regional markets: the North American and the Asian-Pacific markets. The goal is to develop Canadian business to allow it to fill particular needs in these two markets. This seems a strange suggestion in some ways, as it contradicts a long-standing Canadian emphasis on diversification, both of economic endeavours and of markets. However, in a world economy of internationalised production, an economy the size of Canada's no longer has the liberty to pursue wide-ranging diversification. Instead, the focus of Canadian business can be reduced to provide specific needs of the international production process in these two regional markets.

The free trade agreement is particularly useful to this strategy. The FTA guarantees Canada access to the US market, in fact it creates a North American market which, while it is neither as large nor as complete as the European market, can provide certain of the same

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<sup>84</sup> This paper is not designed to offer strategies which particular businesses need to take to improve competitiveness, and thus the following discussion is cast in somewhat general terms.

competitive advantages. This is its second contribution. The FTA is a powerful mechanism for the rationalisation of Canadian business for the American market. However, for reasons of both political and economic long-term security, it would be unwise to allow the Canadian economy to be fully integrated into the American market. Thus, the FTA would have to be used, along with other government action, to provide Canadian niches in the Asian-Pacific, as well as North American, market. Such action would require some of the same steps as the former strategy, particularly research and development; however, it would not require the same commitment of resources, as it would be founded on the market rationalisations of the FTA.

This leaves the question of how such a strategy would address 1992. Essentially, very little would need to be done. The successful rationalisation of Canadian business would provide particular areas of the non-European market in which Canada would be extremely competitive. This would allow Canadian business to compete more effectively with the post-1992 European companies in the non-European markets, because they would have preempted the European rationalisation. The European market would not be ignored, but it would not be emphasised in the planning of the Canadian industrial profile. The EC will almost certainly provide an expanded market for Canadian resources, giving Canada economic support as it restructures its industry. As well, the developments of 1992 would need to be monitored for potential immediate benefits or threats. Such monitoring would be at a level well below that required for the former strategy. Nevertheless, the market completion in Europe may provide opportunities for immediate gain which should not be ignored. Such gains would probably be available at the level of industry, however, and would thus not require government action. Finally, a rationalised Canadian business community might well be competitive even within the EC market after 1992 in the areas that have been stressed for the other markets.

This second strategy shifts the focus of Canadian restructuring away from the European market. It does mean an increased integration with the US market, but that is already an unavoidable consequence of the FTA.<sup>85</sup> In addition to the US market, however, such a strategy involves emphasising Canada's place in the largest and fastest-growing economic region in the world. This will allow Canada to improve its competitive position, but to do so in areas of its choosing. However, as with any economic choices, such a strategy is not cost free, and in this case the costs are, in large part, political.<sup>86</sup> Turning away from the EC would involve denying long-standing historical contacts, which could involve painful political repercussions from the Canadian people. In addition, the members of the EC are also, by and large, our NATO allies. While Canada could argue that such an economic strategy is not related to our security commitments, it is doubtful that the Europeans would be inclined to agree. Thus, this second strategy could also involve some costly international political repercussions.

## Conclusion

The global international trading context is changing, and the fact cannot be avoided that these changes are going to affect Canada. The growth of the three regional markets is going to require Canada to restructure its industry to meet the consequent competitive challenges. In particular, the project to complete the internal market in Europe by the end of 1992 presents Canada with immediate challenges. It seems clear that, in most of its essentials at least the market will be completed. It is thus also likely that the Europeans will pose an increased competitive threat to Canada's trading position, both within Europe and in the global market. At the same time, it also presents interesting opportunities. Canada must make the decisions now as to how to respond. These decisions are urgent as January 1 1993 is less than three years away. If Canada has not made a substantial start in restructuring to face the new international environment, it risks either being left behind, or being left with no choices as to how our industrial restructuring will progress.<sup>87</sup>

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<sup>85</sup> This suggests, of course, that a third strategy could be conceived. This third approach would move Canada away from the United States, by attempting greater market integration with the EC. The (im)practicalities of this approach are beyond the scope of this paper, as it is explicitly designed to examine the changing international context in light of the FTA as well as 1992.

<sup>86</sup> We return once more to the unavoidable link between economics and politics that is so often missed in the pure economic cost/benefit analysis. (See note 70) This is not to suggest that political analysis has not been just as negligent in ignoring the link.

<sup>87</sup> This is, course, a third option. The government could choose (or not choose) to allow the international market forces to decide how Canadian industry will restructure. The FTA will certainly introduce restructuring imperatives into the Canadian market, and so the government could simply allow them to operate, and allow Canadian business to rationalise according to the priorities of American industry. This strikes me as an irresponsible alternative, but it is an alternative nonetheless.

I have outlined two, broad strategic directions for Canada in response to these challenges. In the end, it is the government that must choose which benefits of the two strategies are preferable and which costs are not bearable. Providing an assessment of the costs and benefits is beyond the scope of this paper, but some preliminary suggestions are in order. The first strategy, involving diversification and competitive enhancement by meeting head-on the challenges of 1992, is both costly in economic terms and is potentially impossible, as Canada may simply not be able to match the competitive advantages of the completed European market. In addition, the research and development costs of such an approach are prohibitive. However, such a strategy fits well with Canada's long-standing ties with Europe, with its government's desire for a diversified economy, and its wish to avoid domination by the American market. In addition, by playing the European's game, we are more likely to maintain good relations within our security alliance.

As was suggest above, the second strategy would seem to be the more economically efficient, but the more politically costly. Not only does it involve the political costs of a non-European focus, but it risks ever greater dominance by the American market as Canada rationalises itself increasingly for American production. This may be unavoidable, and the second strategy may be the best way to take advantage of the inevitable, but it is a cost that must be considered.

Unfortunately, neither of the strategies outlined here is perfect. Each involves costs for uncertain benefits. It is for the government to assess those costs and benefits, and to determine the best way for Canada to proceed. This must be done soon, as the changes to the international political economy are progressing rapidly, and if Canada does not act soon, it may be left with few, if any, choices as to how to meet those changes.