

Integration and Harmonization in Europe

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Introduction

There is one aspect of the European situation which appears to have been neglected in recent years and which can be presented by asking two questions. How much do the constitutional aims of the Treaty of Rome and, later, of the Brussels Commission relate to European objectives? And how well do they compare with policies followed in federal countries? The European Community is formally committed to achieving an economic and monetary union (EMU) as well as a political union by 1980; but economists are generally agreed that an EMU will not be established by then (indeed the Commission has recently, and for the first time, admitted as much) and no one seems to know just what the term 'political union' means. Europe therefore is aiming for objectives which are ill-defined and unattainable. The Brussels Commission, though working vigorously, is pursuing policies dealing with various details – advocated in the name of European unity – which do not seem to be really necessary for either political or economic integration.

The underlying theme of much European activity is that policies and practices must be 'harmonized' – or be made the same – and that this is a necessary condition for integration. However, the European Community has consistently failed to determine which matters of policy must be harmonized and which need not if a common market, or even an EMU, is to function effectively. This is surprising for there is no lack of models. Countries such as the United States, Canada, Australia, Germany and Switzerland all function well despite differing practices in their constituent states or provinces. In order to assess the realism of the current efforts to 'integrate' Europe, this article compares the organization that Europe is seemingly trying to achieve with the structure of the greatest federal state in the world, the United States of America.

US constitution

The United States constitution differs considerably from that implied by the Treaty of Rome. Partly this reflects the differing births of the political groupings. The American states gained their independence in 1776 and then had to find a suitable political system to meet their needs. The European Community, on the other hand, was born more through choice than of necessity, and was superimposed on well established nation states.

The American constitution is essentially pragmatic. The country started with immense advantages which Europe lacks—a common language and culture and similar political and legal institutions inherited from the British colonists. The Articles of Confederation, which governed America between 1776 and 1789 when the constitution was adopted, gave the federal government the power to borrow money, coin money, establish a postal system and fix standards for weights and measures. However, the Articles failed to give the central government sufficient power; in particular there was no authority to tax and there was no way in which the states could be forced to carry out their obligations.

Thus the Philadelphia Convention met in 1789 to draw up a new constitution. The need for a stronger federal government was apparent to all, yet the states wanted to retain as much of their independence as possible. It was recognized that coordination of some practices was essential as the lack of a uniform currency, and the existence of tariffs and other barriers to trade, had hampered economic progress. Another cause of concern was that some states would not uphold the laws of others, particularly with respect to debts.

The negotiations at the convention took account of both the measures necessary for effective central government and the degree of decentralization required in the light of the existing needs and powers of the constituent states. A major difference between the problems of the United States then and of Europe today is that the modern European countries are far more developed than were the American states, and have accepted far greater responsibilities to their constituents and electorates. The constitution that emerged was largely that advocated by the Virginia delegation which wanted residual powers left with the states. In addition to the powers stipulated in the constitution the federal government was given authority to 'legislate in all cases in which the separate States are incompetent, or in which the harmony of the United States may be interrupted by the exercise of individual legislation'. The powers of the central government in economic matters are clearly laid down in Article 1, Section 8 of the constitution:

The Congress shall have the power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defence and general welfare of the US; but all duties, imposts and excises shall be uniform throughout the US:

To borrow money on the credit of the US;

To regulate commerce with foreign nations, and among

the several States and with the Indian tribes ;
 To establish a uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the US ;
 To coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures ;
 To provide for the punishment of counterfeiting the securities and current coin of the US ;
 To establish post offices and post roads ;
 To promote the progress of science and useful arts by securing limited times to authors and inventors the exclusive right to their respective writings and discoveries.'

The role of the states is laid down in Article 1, Section 9, Article 4 and the 10th amendment to the constitution :

'States cannot tax their exports.
 States cannot enter into alliances or confederations.
 States cannot coin money.
 States must give full credit to the public acts, records and judicial proceedings of every other State. In particular, States must recognize all contracts made in other States.
 Citizens from all other States must be treated within a State in the same way as citizens of that State.
 All powers that are not delegated to the Federal Government by the Constitution, or not prohibited by it to the States, belong to the States'.

Thus the division of economic responsibilities between the states and the federal government was fairly clear and precise and this still applies today. Washington can levy taxes but they must be uniform throughout the country, it regulates international and interstate trade, it controls the supply of money, it fixes the standard for weights and measures and it organizes the patent system. The states remain free to regulate their internal affairs as long as they do not conflict with the powers of the federal government as laid down in the constitution.

Treaty of Rome

In contrast to the American constitution the Treaty of Rome is an idealistic political document. Its length reflects the desire of its authors to include as many items of agreement as possible and to express general political and social aims – such as equal pay for women. In contrast to the brevity of the American constitution, the Treaty of Rome contains some 250 articles, a remarkable number given that the intention is to remove barriers between states. Not only does the Treaty lay down certain principles, for example that tax differences should not be allowed to distort trade and that a common agricultural policy should be established, it also stipulates in precise terms how some of these principles

should be implemented. The concept of a proper balance between federal and state power, however, is completely absent from it.

The economic logic of the Treaty is far from sound and, as a result, the Community has partly become trapped by its own constitution. The position was aptly summarized by Hans Nord, Secretary-General of the European Parliament, giving evidence to a House of Commons Select Committee in May 1973:

'I believe it true to say that the tendency to harmonize every little bureaucratic measure we have in all our member states is wholly unnecessary. There are federations in this world and we are not a federation. The United States, for instance, is certainly a federation, it has an economic and monetary union but there are many things which are different from one state to another. The feeling you have to harmonize everything is in my personal view a heresy and is utterly unnecessary. Unfortunately, the Treaty of Rome in many cases requires such harmonization.'

One of the Community's Commissioners, Ralf Dahrendorf, has openly criticized this obsession with harmonization. In his famous 'Wieland Europa' article he commented:

'One of the big weaknesses of the first Europe lies in its craze for harmonization. Wherever there was a possibility or even a proposal of a common regulation, then these regulations were established. . . . The good wish to harmonize, which above all seems to have animated the Commission (and made it into a bureaucratic Leviathan), has indeed a few inescapable weaknesses. Whoever tries to look for a similar if not exactly identical solution gets into the dangerous position of generalizing the solution which accords with the highest degree of state regulation. Whoever tries to look wherever possible for similar solutions, that is whoever regards harmonization as of value in itself, very rapidly loses the ability to distinguish between important and unimportant, necessary and superfluous matters. More than that, he interferes with the power of differentiating between regions and countries and runs into the danger of creating a uniform Europe. True, we are still far away from that; diversity is surely more powerful than the power of those in the First Europe; but the search for European solutions for their own sake is already recognizable as incipient ideology – and it is dangerous.'

¹Die Zeit, 9 July 1971, reprinted as 'A New Goal for Europe', in *European Integration*, ed M. Hodges, Penguin, 1972.

Tax harmonization

It is, perhaps, in the field of taxation that European ambitions and American experience differ most markedly. The theory of tax harmonization in integrated areas is well known and generally accepted. The basic principle is that as long as taxes are generally applied in each constituent part of an integrated area, and exchange rates are movable, tax frontiers can be removed without any distortion of competition even though tax rates may differ. If the destination principle of tax is applied (that is, if goods are taxed in the country of sale rather than of production) competition need not be distorted however much tax structures and rates may differ.

Taxation aims in Europe

Given these principles, it appears that the present tax differences in the European Community do not greatly distort competition although the continuing existence of tax frontiers is an administrative nuisance. However, the Commission has proposed a wide range of harmonization measures, some of which are in the process of being implemented.

VAT, as an indirect tax, when applied under the destination principle, prevents any distortion of competition and allows rates to differ between countries. The Commission, however, is not satisfied with this and has advocated complete uniformity of tax rates. 'The alignment of VAT rates which constitutes the main step towards the abolition of tax frontiers will have to be achieved progressively by measures to reduce the number of rates in the Member States, and to draw up a joint list of goods and services subject to each of these rates.' In pursuance of this the Commission has published a 100-page draft directive on harmonizing VAT rates.

Excise duties, by their very nature, are not general. As long as the goods subject to these duties and the rate of duty differ, tax frontiers must remain if competition is not to be distorted. However, the Commission has advocated the harmonization of excise duty structures 'to ensure greater neutrality of the tax in the field of competition' and has gone further and has said that alignment of rates will be needed because existing differences are so great that they 'are liable on the one hand to affect the consumption of competitive products and on the other . . . to militate in favour of companies situated in Member States applying distinctly lower rates'.

With regard to corporation tax, the Commission has recently suggested that the imputation system should be adopted throughout the Community. This would conform with current British practice. Previously the Commission had favoured the adoption of the classical system.

Position in America

It is somewhat ironic that the one tax that is most centralized in America is individual income tax, seemingly the only important tax which the European Commission does not wish to harmonize. The federal government levies a uniform income tax, at comparatively high rates, throughout the United States. The state income taxes are far less important and some states, including Texas and Pennsylvania, do not levy one at all. The structure of the state taxes varies markedly. Some states, for example New Hampshire, only tax certain categories of unearned income, some have only one rate, while others have as many as fifteen steps. Personal allowances vary considerably and in only seventeen states is federal income tax allowable as a claim against state tax.

Corporate income tax is also largely a federal matter although most states also have their own tax with rates varying between 2 per cent in Indiana and 12 per cent in Minnesota. Many states tax smaller businesses at a reduced rate and most tax some or all financial institutions at a different rate to business corporations.

The federal government and the states raise similar amounts through excise duties. The federal government taxes alcohol, tobacco, petrol, and airline tickets as well as a few other unimportant items. The states tax a wide variety of goods, the most common being alcohol, tobacco, petrol, insurance and public utilities. The differences between the states' tax rates are such that it is not uncommon for people to cross state frontiers to buy certain goods.

For cigarettes the tax range is from 2 cents per packet in North Carolina to 21 cents per packet in Connecticut. It is interesting to note, with respect to tobacco, that states do not even have the same tax structure, something which the Commission has been advocating energetically in Europe. While most states impose a fixed tax per packet, Hawaii levies a percentage tax on the wholesale price and New Hampshire a percentage tax on the retail price. For petrol, most states raise a tax in the range of 7 to 9 cents per gallon with the minimum being 5 cents per gallon in Hawaii and the maximum 10 cents per gallon in Connecticut. For alcohol the range is from no tax in seventeen states to 4.53 dollars per gallon in Minnesota.

Technically, customs barriers exist between states, but in practice these are often ignored except where 'smuggling' is on a commercial scale. Pressure in America is for less centralization rather than more; and the states have been urging the federal government to remove certain of its excise duties, especially those on alcohol and tobacco, so as to give them exclusive use of these taxes.

In Europe, VAT is the symbol of the tax harmonization programme, but in America general indirect taxation is entirely within the prerogative of each state. Most levy a tax within the range of 3 to 4.5 per cent, a few levy nothing at all, and the highest rate is 6.5 per cent in Connecticut. The structure of these taxes differs considerably from state to state with widely varying rules for the exemption of goods, particularly of cars sold to non-residents.

Social security

An essential requirement in the social welfare field is that differing national regulations should not be an obstacle to the mobility of labour. This has already largely been achieved in Europe by the transferability of benefits through reciprocal arrangements. However, this has had little effect on the mobility of labour since by far the most important factors in this respect are language and cultural differences.

The Commission has more ambitious ideas. Among the measures that it has supported have been:

- a) A common vocational training programme.
- b) Harmonization of social security policies.
- c) An action programme on hygiene and safety at work.
- d) Participation of both sides of industry in the decision-taking process.
- e) An examination of the recruitment of workers through private employment agencies.
- f) A common minimum wage, a forty-hour standard week and four weeks minimum annual holiday.
- g) Harmonized collective bargaining.
- h) Common lay-off procedures. These would include an obligation to be placed on employers to consult workers' representatives before mass dismissals are made and also to give at least three months' notice to the competent national authorities together with the reasons for the dismissals.

The Commission's attitude to social policy has been firmly stated by the Director General for Social Affairs, Michael Shanks: 'Ideally, all these benefits (hours, social security payments, subsidies etc.) should be harmonized if Europe is to become a single market.'

Most of these measures have only a remote connection with labour mobility and would not be tolerated in America. There is, in fact, a national minimum wage in the United States but evidence suggests that this has been a cause of unemployment, particularly among young black people, and it would not seem to be an example to be followed. Thirty-seven states have their own minimum wage regulations — largely to fill gaps not covered by federal legislation.

Unemployment insurance in the United States is largely in the hands of the states although the finance in effect comes from the federal government. Revenue for the scheme comes principally from a tax levied on employers – who are able to offset the cost against federal tax liability – although four states also levy a tax on employees. Eligibility for unemployment benefit (for example the minimum number of weeks that must be worked before any benefit is paid) varies widely between states, as does the amount of benefit paid.

Benefits for the old, for widows and for orphans are almost entirely under the control of the federal government. Selective assistance, such as for low income families and the blind, is at the discretion of the states although help with finance is available from Washington. In this, as in so many matters, the policies of the states vary widely. For example, in a number of states only short-term assistance is given. Injury insurance is operated entirely at the state level. All states operate some sort of scheme but in only thirty is it compulsory.

Transport and communications

The Post Office in America is run entirely by the federal government as a department of state. The system is completely unified and the states have no role at all. The constitution itself lays down that the Post Office should be centrally organized. In Europe, by contrast, the Post Office has remained strictly in the hands of the national authorities.

The states are largely responsible for the road network in America although they cooperate with the federal government for major national roads. Since the 1930s an interstate commission has ensured that traffic signs are kept uniform throughout the country and the Interstate Transport Commission regulates transport between states.

The Commission's main preoccupation regarding transport in Europe has been to promote common driving licences and common specifications for lorries. In the case of the former the commission has gone to quite remarkable lengths. A draft directive called for periodic medical tests, practical and theoretical tests and a psycho-technical examination. (An interchange in the House of Commons at the end of 1973 showed just how far Europe is pushing ahead with uniformity. Mr John Biffen pointed out that regulation 543/69 compelled drivers of minibuses used on farms to be at least twenty-one years of age. The Minister of Transport, Mr John Peyton, said that this was a Treaty obligation but that he intended to seek some relief for minibuses before the regulation came into effect at the beginning of 1976.) In America the states retain full control over the issuance of driving licences. The

minimum age for holding a licence is fifteen years in New Mexico, sixteen with parents' consent in Kansas, seventeen in New Jersey and eighteen in West Virginia. The cost of driving licences varies between \$2 and \$12 and they are valid for anything between one and five years.

The problem of lorry sizes is a continuing one in America, largely because truckers have successfully promoted state legislation that effectively restricts competition from other states. Only a few states have so far been able to overcome the truckers' lobbying efforts against weight-distance taxes on heavy vehicles. Europe's problems with differing axle weights are not unique; but the issue seems to have generated considerably more heat in Europe than it has in America.

Industry and commerce

The American constitution specifically puts the patent system as well as the Post Office in the hands of the federal government, with the states having no powers. Europe is also moving towards a centralized patent system and this is one field in which the Community can point to solid progress.

A European programme for harmonizing standards is essential, but opinions differ on how far it should go. Progress has therefore been painfully slow. In the United States a uniform system of weights and measures was provided for in the constitution and was duly established in 1890. A National Bureau of Standards came into operation in 1901 to administer the system and it is also responsible for testing products to ensure that they meet stipulated specifications. The Federal Food and Drug Administration is responsible for ensuring that safety standards are maintained and it issues permits of drug safety. It also controls the labelling of hazardous substances and food packaging and labelling. Some states have also imposed their own restrictions on top of federal standards, often with the deliberate intention of preventing competition. Examples have been rigid rules on the inspection of cattle coming into a state, rules on sausages that effectively outlaw those coming from other states, taxes on wine being lower if grapes are produced locally and so on. Under the guise of quarantine regulations, California has even prohibited people from bringing fruit and vegetables into the state.

The Commission's plans for harmonizing company law in Europe are very ambitious, but as yet little progress has been made on implementation. In America the state governments have largely retained responsibility for regulating the affairs of businesses within their borders although the Federal Securities Exchange Act of 1934 introduced a greater

element of central regulation. The states still determine the conditions of partnerships, issue charters for private companies, and licence the professions.

Insurance has recently provided a good example of how the American states cooperate. Following the collapse of many insurance companies in the 1960s there was a threat of federal legislation. Instead, the National Conference of Insurance Commissioners, who are responsible for regulating insurance in each state, drafted a model bill in 1969 to protect the victims of insurance insolvencies and nearly all states have now enacted legislation based on this model.

Anti-trust policy has been vigorously pursued by the European Commission but national legislation still predominates in this field. This is not unreasonable as, of course, industry in Europe is still largely organized on a national level. In America, anti-trust policy has been increasingly centralized in line with the growth of big business. By the end of the nineteenth century it had become clear that existing anti-trust regulations were no longer effective and the Sherman Act of 1890 marked the first step in combating monopoly power at the national level. The Clayton Act and the Federal Trade Commission Act of 1914 further strengthened the role of the central government in this field. About thirty states still retain their own anti-trust laws but these are seldom enforced and frequently ignored. Recently the states have been attempting to make their laws more uniform and consistent with federal legislation.

The European Commission has been trying, energetically if not always successfully, to limit the aids that national governments give to subsidize and to attract industry. In the United States the states actively compete with each other to attract industry and advertise how favourably their inducements compare with those of other states. It is somewhat ironic that in Brussels, where efforts are being made to harmonize aids to industry in Europe, no less than eight American states have established offices, partly with the intention of attracting European investment. Idaho seems to be the least generous state, offering very few direct aids, and California and New Jersey are among those offering only a small range. New Jersey has recently introduced a revenue bond financing scheme to help it compete with other states in attracting industry. New York and Hawaii give almost every conceivable form of assistance and Connecticut and Maryland are also fairly generous. Virginia and Pennsylvania, both of which have offices in Brussels, have also been expanding their aid packages recently. Pennsylvania now claims to have 'the best financial package of any state in the union'.

Most states offer revenue bond financing, and in about half of them there is aid for existing plant expansion. Somewhat less prevalent are loans for building construction, loan guarantees for building construction, and special incentives for locating in areas of high unemployment. Tax incentives offered in various states include accelerated depreciation on industrial equipment and corporate tax exemption, and in two states there are tax credits for the use of specified state products.

Banking

Europe's objectives in the banking field are to remove restrictions on capital movements and to encourage the creation of transnational financial institutions. Little progress has been made in either of these fields. In America, capital flows freely between the states and the structure of banking shows that a monetary union can function effectively when financial institutions do not operate throughout the integrated area.

The American states are largely responsible for the control of financial institutions that operate within their borders and they have almost complete control over the structural aspects of banking. They are responsible for auditing and checking financial institutions, they regulate the issuance of securities and they control reserve and loan regulations. Where banks trade in more than one state they must register under federal rather than state law and they then become the responsibility of the Federal Reserve System.

Banking regulations vary widely between states with the greatest variations being in respect of branching. There are some 14,000 banks in the United States of whom 75 per cent have no branches at all. Twelve states, including Illinois, do not allow any branching and a further twenty place a geographical limitation on branching within the state. Branch banking is most developed in California where the Bank of America alone has some 1,000 branches. No bank is allowed to have branches in more than one state. Holding companies have been used to overcome the restrictions to some extent and banks have also developed direct links with each other. The recent Hunt Commission in America, which studied branch banking, suggested that statewide branching should be allowed but it rejected proposals for federal legislation to permit interstate banking.

Cooperation between states

The American states obviously have to cooperate with each other in a great many fields and the mechanisms by which they do so are of some relevance to Europe. However, no strict comparison can be made with the European Community because, unlike the United States, it has no strong central government with clearly defined powers.

A standing body exists in America to provide for the continuing enactment of uniform state laws as an alternative to federal legislation – the National Conference of Commissioners on Uniform State Laws established in 1892. It drafts model laws where they are felt to be necessary and these are then introduced into the state legislatures by the normal means. By 1966 the conference had prepared seventy-one acts that were recommended for adoption by all states on a uniform basis, eighteen acts recommended as models because complete uniformity was not felt to be desirable and twenty-five acts that were not widely adopted but which the conference chose to recommend as suitable for consideration. Variations on the model laws are, of course, acceptable but the intention is that these should represent conscious policy decisions with the consequences being known in advance, rather than being accidental. Among the recommended acts that have been most widely adopted are those on criminal extradition, gifts to minors, partnerships, narcotics and simultaneous death.

Similar bodies exist for specific problems – those concerned with insurance and traffic signs have already been mentioned. A recent innovation is the Multistate Tax Commission which was established to look at the problems caused by tax differences between the states and to draw up rules to overcome these. Like the National Conference it operates on an entirely voluntary basis.

There are also a great many individual cooperation agreements between states for problems that cross state frontiers. For example, the Port of New York Authority, established in 1921 by New York and New Jersey, is responsible for airports, tunnels and bridges as well as the port itself. A more recent example of cooperation is in the Delaware Valley, where local as well as state governments are involved. In 1959, fourteen governmental units, including the states of Pennsylvania, Delaware and New Jersey, formed an agency to formulate a regional transport plan. In 1965 further progress was marked by the establishment of the Delaware Valley Regional Planning Commission. The Delaware Valley shows that Europe is not alone in its harmonization problems. An official of the Planning Commission was quoted in *The Times* of 27 June 1974 as saying: 'This region is an economic entity; one labour market, one job market, one market for business and industry – a metropolitan urbanized state. But with nearly 380 self-governing municipalities in the region, political unity is difficult if not impossible except for limited functions.'

In this article I have looked at the measures adopted or

planned in Europe, and compared them with those existing in a long-established federation. It is of course quite wrong to take the United States as the definitive model of an integrated area. Despite the brilliance of their constitution the Americans are well aware that their structure causes economic problems. There have been strong pressures, for example, for increasing central control with respect to social security.

However, their experience shows clearly that a monetary union and a political union can function effectively despite considerable differences in policies and practices within the area. Thus taxes do not need to be harmonized, and differing levels of state aid to industry do not distort competition to an unacceptable degree. Central control of the money supply, however, is important.

Conclusion

The American experience suggests that Europe has failed to get its priorities right. Much effort, often tending to be divisive rather than unifying, has gone into the problems of the VAT base, uniform axle weights and common driving licences, yet progress in these fields can help little towards the true integration of markets.

One way in which the unity of the American market, compared with Europe, is clearly illustrated is the lack of discriminatory procurement. State governments, and indeed private individuals and corporations, may favour their own state products to a small extent but in general they look on the whole of the United States as one supplier. In Europe, discriminatory procurement is still the order of the day. Until the political will exists for progress to be made in this respect there seems to be little point in the Community tinkering with harmonization measures which can, at best, be of little benefit.

The question of defence raises an interesting contrast between the United States and Europe. Surely the most fundamental element of a political union is a determination to defend the common area against an external enemy. Yet there is no defence policy within the framework of the European treaties. Indeed, the European countries are not even all prepared to belong to a common defence treaty. This lack of common policy, of even a willingness to work closely together as nation states, renders extremely hollow any policies or intentions of proceeding towards political union.

I have compared the European and American experiences in this article, largely because the United States happens to be the federal country for which most information is available.

Other federal countries manage, however, to function in an even more decentralized way than the United States. I would hope that political and constitutional experts might be interested in examining this point further, using other countries as examples. There was a spirit of enthusiastic idealism regarding the development of Western Europe when the Treaty of Rome was drafted, and this impetus had the effect of getting European integration under way. However, it is now abundantly clear that the objectives and means adopted are completely inappropriate in the light of modern conditions and the powers and needs of the individual nation states. If the European institutions are not to do a considerable amount of damage, this question of proper harmonization and balancing of powers must be re-examined in a realistic light.

Biographical Note

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