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INTRODUCTION

The Treaty of Rome establishing the European Common Market went into force on January 1, 1958. At the time there was considerable skepticism in some quarters that a restructuring of national economic relationships as far-reaching as that projected in the Treaty would reach fruition. It was known that numerous uncertainties lay ahead in the compromising of conflicting points of view of the various interests affected at every stage of the transition period. There was ample precedent for believing that such an ambitious experiment in economic integration would fail.

Now that the Common Market is more than seven years old, the doubts concerning its permanency have begun to recede, although it is realized that there may still be pitfalls on the road to final realization of the plan. Notwithstanding that serious disagreements have occurred in the continuing negotiations, it is a fact that much progress already has been made toward the goal of fusing the six member economies. At mid-1965 tariff reductions and other changes leading to economic integration were approximately three years ahead of the original timetable. Tariffs between the six members have been reduced to less than fifty per cent of their levels in 1957. Recent proposals by the European Economic Community Commission called for abolishing all duties by July 1, 1967, and final alignment of national tariffs on the common external tariff by that time. The adoption of these proposals, however, must now await resolution of additional fundamental disagreements which recently have occurred.

From the outset one of the concerns of those who questioned the workability of the Common Market plan was the possibility that it might prove to be an unbalanced, hence an unstable, arrangement due to excessive differences in size of the separate economies. It was thought that another stumbling block might be the disparities in levels of development of the national economies comprising the Common Market. In particular, it was argued by some that the economy of West Germany, because of its larger and more heavily capitalized industrial base, its aggressive business leadership and other advantages, would benefit from the arrangement more than its partners. There were those who reasoned further that these advantages could even work to the detriment of one or more other members which might be overwhelmed by German economic power unless more safeguards were added. Probably the most forthright presentation of this view has been made by the English economist, E. Strauss. The present study undertakes to investigate this hypothesis insofar as conclusions may be drawn from the first six years of the Common Market's operation. Though the separate economies of the bloc are not yet fully integrated, quantitative trade restrictions largely have been removed and movements of capital and labor increasingly freed along with the previously mentioned tariff reductions.

Anyone familiar with recent literature on the Common Market will have noted that several writers have either traced its development to earlier and more limited attempts at unification or have drawn analogies between this latest effort at economic integration and others which have been made in the past. In this connection, the German Zollverein of the nineteenth century has often been mentioned as a precedent, and comparisons have been made between it and the Common Market. Possibly the most provocative treatment to be found is that in E. Strauss' book, Common Sense about the Common Market, published in 1958.

In Chapter II, we have briefly sketched the development of the Zollverein, using material from several basic histories, and then attempted to evaluate Mr. Strauss' views. Chapter III reviews the more contemporary events leading up to the Treaty of Rome, again using Mr. Strauss' book as a springboard for a discussion in which an attempt is made to show that the creation of the Common Market was not German-inspired.

Chapters IV, V and VI are basically empirical in character. Chapter IV gives the balance of payments histories of the six Common Market nations and Greece, which is now an associate member.

Chapter V presents a brief review of recent customs union theory, especially that part which has a bearing on this study. It also includes a description and analysis of data relevant to the economic growth and the foreign trade of the member nations.

Chapter VI contains data on labor and capital movements. The data for the entire study were derived from publications of official international organizations.

Chapter VII summarizes the findings and offers conclusions as to whether the hypothesis concerning German domination of the Common Market is justified.

CHAPTER II

THE ZOLLVEREIN AND THE COMMON MARKET

"The German Empire has been built," wrote Keynes, "more truly on coal and iron than on blood and iron."[1] Like most other epigrammatic summaries of a complex historical and economic process, this one scarcely begins to explain the foundation of German industrial growth. And, as Norman Pounds shows in his essay, "Economic Growth in Germany,"[2] Keynes' statement, by its misplaced emphasis, may give the impression that only because and until Germany began to exploit reserves of her basic raw materials did she make any industrial progress. Actually, Pounds says, Germany had a considerable amount of manufacturing industry before it was known that she possessed much in the way of natural resource endowment. Veblen once even wrote that, "As is well known,

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[1] J. M. Keynes, The Economic Consequences of the Peace (New York: Harcourt, Brace and Howe, 1920), p. 81.

[2] Hugh G. J. Aitken (ed.), The State and Economic Growth (New York: Social Science Research Council, 1959), p. 190. Papers of a conference held Oct. 11-13, 1956, under the auspices of the Committee on Economic Growth.

the Fatherland is not at all specially fortunate in natural resources of the class that count toward modern industry."[1] Rostow places Germany's tentative date for the take-off into economic growth at between 1850 and 1873,[2] or from two to three decades before her pig iron production even began to approach the volume of British production.[3]

Economic historians frequently cite the organization of the Zollverein as a major factor promoting rapid economic development in Germany after a belated start.[4] To understand the importance of this institution to Germany's economic development it is only necessary to recall how divided the German world still remained as late as the beginning of the nineteenth century.

"Until the nineteenth century the Germans made less progress towards national unity than the other peoples of

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[1]Thorstein Veblen, Imperial Germany and the Industrial Revolution (New York: Viking Press, 1939), p. 180.

[2]Walter W. Rostow, The Stages of Economic Growth (London: Cambridge University Press, 1960), p. 38.

[3]J. H. Clapham, The Economic Development of France and Germany (3d ed,; London: Cambridge University Press, 1928), pp. 283-284.

[4]Ibid., pp. 96-97. Also Pounds, op. cit., and W. O. Henderson, The Industrial Revolution in Europe, 1815-1914 (Chicago: Quadrangle Books, 1961).

Western Europe."[1] The Reformation and religious wars of the sixteenth and seventeenth centuries, far from helping to unify the Germans as had happened in Britain, deepened their divisions. What semblance of unity had been provided by the Holy Roman Empire (of which it has been said that it was neither holy nor Roman) was weakened by the Peace of Westphalia of 1648 concluding the bloody Thirty Years War.

"In the century and a half which followed the peace settlement Germany remained a mosaic of more than 1,800 political entities, ranging in size and influence from the seventy-seven major secular principalities down to the fifty-one Imperial cities, forty-five Imperial villages and 1,475 territories ruled by Imperial knights."[2]

By the end of the Napoleonic wars a marked change had been wrought in this extreme fragmentation, though Germany still remained badly divided. In the course of remaking the map of Germany, Napoleon drastically reduced the number of states. Even so, the Congress of Vienna, after the wars, divided Germany into no fewer than thirty-nine separate

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[1] E. J. Passant, A Short History of Germany, 1815-1945 (London: Cambridge University Press, 1962), p. 1.

[2] Ibid.

states, the largest of which were Austria and Prussia and several of the smallest of which were little more than insignificant principalities. Thus Germany was still hardly more than a "geographical expression."

The devastating effect on commerce of these archaic political divisions was aptly described by a German newspaper of the period.

> Thus we have instead of one Germany, 39 German states, an equal number of governments, almost the same number of courts, as many representative bodies, 39 distinct legal codes and administrations, embassies, and consulates . . . in these 39 states prevail as many separate interests which injure and destroy each other down to the last detail of daily intercourse. No post can be hurried, no mailing charge reduced without special conventions, no railway can be planned without each seeking to keep it in his own state as long as possible.[1]

In view of difficulties thus created not only for economic progress but for ordinary commerce, it is no wonder that growing pressures developed for rationalization of the existing political structure. These pressures found increasing expression not only among the commercial classes but also among a growing proportion of the educated middle class in the free professions and in industry.[2]

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[1]Quoted in Theodore S. Hamerow, Restoration, Revolution, Reaction (Princeton, N. J.: Princeton University Press, 1958), p. 17.

[2]Passant, op. cit., p. 26.

But Germany's political disunity was doomed perhaps more by swift economic and technological change than by anything else.

The Customs Union Movement

Because of the grave hindrances to commerce represented by the patchwork of states and principalities, customs unions began to be formed as early as 1828. Prussia, the largest and most powerful state in Germany other than Austria, was the leader of one of these. By means of shrewd and aggressive commercial policies in which full use was made of her territorial advantages and greater financial power, Prussia by 1834 expanded this union into a greater one called the Zollverein.[1] Besides Prussia, it included the larger German states of Bavaria, Saxony and Wurttemberg and most of the smaller ones, with a total population of twenty-three and one-half million.[2] Within eight years several others joined so that by 1842, except for Austria, only the Kingdom of Hanover and a few other lesser states in the north remain-

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[1] *Ibid.*, p. 66. See also Shepard Bancroft Clough and Charles Woolsey Cole, *Economic History of Europe* (Boston: D. C. Heath & Co., 1941), p. 457.

[2] Passant, *op. cit.*, p. 66.

ed outside.[1] It became a cornerstone of Prussian policy to exclude Austria from the Zollverein. The relations between Austria and Prussia carry a special significance and receive further description below.

Henderson writes that

> the Zollverein was founded after fifteen years of bitter economic strife that followed the issue of Prussia's tariff of May, 1818. The notion that it was set up as the result of the rise of German national consciousness and was a touching example of brotherly cooperation will not bear examination for a moment . . . The states concerned fought for their own narrow interests and many of them joined the Zollverein only when economic depression and empty exchequers made further resistance to Prussia impossible.[2]

All states on entering the Zollverein automatically adopted the Prussian tariff and shared in revenues in proportion to their populations.[3] Duties were low for that time. Raw materials were admitted duty-free. The duties on manufactured articles averaged only 10 per cent ad valorem, while rates on tropical products ranged from 20 to 30

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[1] Ibid., p. 67.

[2] W. O. Henderson, The Zollverein (1st U. S. ed.; Chicago: Quadrangle Books, 1959), p. 95.

[3] E. Strauss, Common Sense About the Common Market (London: George Allen & Unwin. New York: Rinehart & Co., 1958), p. 25. Also Passant, op. cit., p. 68.

per cent ad valorem.[1] The Cambridge historian, J. H. Clapham, termed the Prussian tariff of 1818 "immeasurably the wisest and most scientific tariff then existing among the great powers."[2] There was a tendency for the Zollverein tariff to rise gradually, especially by the 1840's, probably in some degree under the influence of Friedrich List who had secured the sympathetic ear of German industrialists with his National System of Political Economy.[3] But a reversal of this tendency took place in the next two decades, and Germany proper remained a low-tariff area until after the founding of the Empire.[4] If the influence of English free-trade doctrines on Prussian policy-makers is part of the explanation for a low-tariff policy, so also is the fact that such a policy fitted in well with Prussian determination to keep Austria out of the Zollverein.[5]

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[1]W. O. Henderson, op. cit., p. 40. Also Clough and Cole, op. cit., p. 457.

[2]Clapham, op. cit., p. 97. Also Herbert Heaton, Economic History of Europe (2d ed. rev.; New York: Harper & Brothers, 1948), p. 642.

[3]Clapham, op. cit., p. 101. Also Henderson, op. cit., p. 179.

[4]Clapham, op. cit., pp. 315-16.

[5]W. O. Henderson, The Genesis of the Common Market (Chicago: Quadrangle Books, 1962), p. 107.

Prussian-Austrian Relations

Austrian relations with Prussia and the rest of Germany, especially with respect to Austria's position and attitude toward the Zollverein, are of special significance. Austria emerged from the Napoleonic era the undisputed leader of the German world. All of her dominions to the east, however, which constituted the bulk of her territory, were non-Germanic. Therefore, they were not in the Germanic Confederation formed after the Congress of Vienna to replace the old Holy Roman Empire. Austrian interests, thus, were necessarily divided, and it was difficult for the government to formulate policy in relations with the German states in disregard of the impact of that policy on the rest of the Empire. A policy which would have strengthened the Austrian position in Germany was apt to react adversely on the economy of the eastern provinces.[1] This dilemma was not greatly different from that which confronted Britain in defining policy toward the Common Market in 1962.[2]

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[1]Strauss, op. cit., p. 27.

[2]At the time British opinion was sharply divided on the question of seeking membership in the Common Market, a step which eventually would have come in conflict with Commonwealth preference. Britain's application was rejected, thus postponing the necessity of making a final decision on whether to abandon the principle of Commonwealth preference.

Austria remained the dominant power in the Germanic Confederation until about the mid-1850's. After that her influence began to wane, almost imperceptibly at first. The fundamental cause of this gradual loss of leadership was the slower pace of economic development in Austria as compared with that in the territory covered by the Zollverein and especially in Prussia itself.[1] Western and northern Germany was experiencing rapid industrial progress throughout this period, but much of the Austrian Empire remained predominantly agrarian, while its industries were slow to modernize. At times her leaders sought to force a way for Austria into the Zollverein in order to retain a strategic role in Germany.[2] At other times they tried to break up the Prussian-led customs union by inducing the important southern German states to withdraw.[3] Prussia leadership, dedicated to keeping Austria out, not only was successful in that respect, but also in holding the union together despite occasional internal crises. Its success was facilitated by the

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[1]Henderson, The Genesis of the Common Market, p. 107. Also Strauss, op. cit., p. 27.

[2]Clapham, op. cit., pp. 315-16. Also Strauss, op. cit., p. 27.

[3]Henderson, The Genesis of the Common Market, p. 106.

relative inefficiency of Austrian industries and their need for high protection.[1] By keeping the Zollverein's import duties low in line with prevailing sentiment, Prussia practically assured the exclusion of Austria, many of whose producers would have found it impossible to survive if exposed to outside competition. When in 1854 Prussia was able to secure the renewal of the Zollverein treaties with all its existing members and gain the adhesion of Hanover besides, Austria in effect lost its last chance to destroy or dominate the Zollverein. The renewal of these treaties placed Prussia at the head of a customs union with a population of thirty-six million and greatly strengthened her hand in Germany.[2]

The War of 1866

Twelve years later the issue of leadership in Germany was finally laid to rest by the War of 1866. In seven weeks Austria was crushed, though now allied militarily with the other major states of the Zollverein against Prussia. "The links which had been forged between Prussia and other members of the Zollverein were not strong enough to prevent Hanover

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[1]Clapham, op. cit., p. 316.

[2]Henderson, The Genesis of the Common Market, p. 107.

and the south German states from becoming Austria's allies. Political antipathy proved to be more powerful than economic interests."[1] True to the fears of German businessmen, the Zollverein was legally dissolved, but unforseen by them, it in fact continued to operate. For the war actually proved the importance of the customs union to its member states and their economies. The Zollverein treaties automatically lapsed with the beginning of hostilities, but there was no interruption in the collection of duties and their dispatch to Berlin, the Prussian capital. They were then divided according to the old agreements, even to those states now in arms against Prussia.[2] This remarkable procedure can either be viewed as a cynical policy of business as usual or as a demonstration of the moderate nineteenth century concepts of war and nationalism.

In the post-war settlement Prussia annexed Hanover outright along with several other north German states, all of which were organized into the North German Confederation. The other members were the same south German states as had been members before the war.[3]. Austria, though receiving

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[1]Ibid., p. 108.

[2]Ibid., Also Strauss, op. cit., p. 40.

[3]Henderson, The Genesis of the Common Market, p. 109.

generous treaty terms from the astute Bismarck, was permanently expelled from Germany proper.

Political Unity Attained

The final act in the drama of unification was not played until 1871, and once more it was a war that forced the issue. Bismarck "planned" the war against France but very cleverly maneuvered the French emperor into taking the role of the aggressor.[1] The South German states were now on the side of Prussia against the common enemy, France. Again it was a short war, lasting less than six months, at the end of which France was thoroughly defeated.

"While the war was in progress, one after another of the South German states had been admitted to Confederation; Bismarck had gradually overcome the opposition of the monarchs, including William [King of Prussia] himself, to the imperial project; and on January 18, ten days before the capitulation of Paris, William I had been acclaimed German emperor by the assembled princes in the Hall of Mirrors at Versailles."[2] Thus Bismarck had created a German Empire with the King of Prussia as hereditary emperor.

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[1]John Hammerton and Harry Elmer Barnes, The Illustraed World History (New York: Wm. H. Wise & Co., 1938), p. 898.

[2]Ibid., p. 900.

By the creation of the German Empire the German people at last achieved political unity. Practically all the German-speaking peoples of Europe except the Austrians, the Luxembourgers, and the people of the small state of Lichenstein, were now united in a single Reich. The achievement, however, was not so much the result of a general consensus, either of the people or their leaders, as it was of the policies and actions of Prussian statesmen, especially in the later years, of Bismarck.[1] The Zollverein played a large part in the process, but its success was due almost entirely to Prussian leadership. Other states were frequently reluctant to join and did so only under economic duress. Economic decay and depression would very likely have been their lot

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[1]The idea of German nationalism, though talked about and advocated by a wide variety of writers and men of affairs for many years, was opposed not only by the majority of the princes but by quite a large body of the people. " . . . to the main body of the nobility and even to many of the middle class, nationalism, with its threat to the local court and to the traditional ordering of society and with its leveling implications as deriving from the French Revolution, became as repugnant as to the sovereign prince himself." --Passant, op. cit., p. 15. Nationalism evoked little interest even among the kings of Prussia as is clearly implied in the quotation from Hammerton and Barnes above. A concrete example is the action of Prussian king in giving a de facto rejection of the offer of the Constitutional Assembly assembled in Frankfurt-on-Main in 1849 to make him a constitutional monarch of a unified Reich. See Passant, op. cit., pp. 34-35, and Henderson, The Zollverein, pp. 195-196.

had they remained outside.[1] Even as members they continued restive, and more than once a breakup of the Zollverein was a possibility.[2] Prussia's partners were understandably jealous of her power and regarded her domination of the customs union with distrust. "Some states desired to weaken the Zollverein even at the cost of reviving tariff barriers throughout Germany."[3] Prussia made membership financially attractive by the method of division of customs receipts. Distribution on the basis of population caused the smaller states, with few exceptions, to draw more from the Zollverein than they paid in as receipts. This also applied to the larger states except Saxony. Prussia itself contributed considerably more in the form of customs receipts to the treasury than it kept as its share of the revenues.[4]

It would be easy to exaggerate the contribution of the Zollverein to the economic development of Germany in the approximate half century of its existence. Nonetheless, it

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[1]Henderson, The Zollverein, p. 95. Also Strauss, op. cit., p. 24.

[2]Henderson, The Zollverein, pp. 190-95. Also Passant, op. cit., p. 68.

[3]Passant, loc. cit.

[4]Henderson, The Genesis of the Common Market, pp. 103-104. Also Strauss, op. cit., pp. 25-26.

is hard to conceive of Germany's becoming the leading industrial state on the continent during this period except under some type of regime which would be equal to the problem of overcoming the restrictions which antedated the formation of the Zollverein. True, that regime need not inevitably have been the customs union known as the Zollverein. It might have taken any of several other forms, as Henderson has pointed out, or have been organized under the joint leadership of Austria and Prussia, or Austria alone.[1] That it achieved the success it did over serious outside opposition and general distrust of Prussia by the other German states was due in no small part, according to Henderson, to the dedication and skill of important but little known Prussian civil servants who carried on the periodic negotiations and the planning necessary for the survival and growth of the union. "The Zollverein is the contribution of the Prussian Civil Service to the founding of the German Empire."[2]

Zollverein and Common Market Contrasted

These two institutions separated in time by a hundred

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[1] The Zollverein, p. 342.

[2] Ibid., p. 343.

years have certain basic similarities, mainly in purpose and principle. These similarities have already been well covered in several books, among them those from which we have quoted. It is possible, however, to push these similarities too far. By doing so one can read into the Common Market's development certain dangerous implications concerning its use by Germany for economic penetration and domination of Europe. This is part of Strauss' thesis. His analysis can be taken as representative of this point of view, though perhaps some readers would consider it a little on the extreme side. Let us look a little more closely at some of his ideas. For this purpose some quotations from his book Common Sense about the Common Market will suffice. In this volume he has skillfully blended both historical and technical economic criteria to support his argument.

"In brief, from the German point of view the Common Market plan is an economic gold mine and German policy has naturally been intent on ensuring its success."[1] "The Common Market Treaty . . . has made it plain for all to see, except for the wilfully blind, that in the structure of any future European Union Germany will occupy the ground floor

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[1]Strauss, op. cit., p. 85.

and not the basement."[1] By committing the future of European economic integration to the care of Western Germany, the signatories of the Treaty of 25th March 1957 have embarked on an unjustifiable gamble.[2] "The result has been the emergence of an economic block, dominated in all essentials by broadly overlapping powers of big business and Western Germany but making considerable allowance for the special interests of its other member states and for those of the farming community in all Common Market countries."[3] And finally,

> This issue is not whether there shall be European economic integration, but what form it will take. If the conception underlying the Common Market Treaty should win the day, it will be increasingly dominated by a highly dynamic but basically unstable Germany, politically divided and thereby unbalanced in more senses than one, capable of drawing its neighbours into its sphere of influence not through hope of common benefits but through fear of the consequences of staying outside. This development will not be prevented by a device permitting British business to share in the advantages of such an arrangement on more or less even terms with Germany, and with equally little concern for the effects of such a solution on Europe as a whole. In such a contest, the ad-

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[1] *Ibid.*, p. 121.

[2] *Ibid.*, p. 127.

[3] *Ibid.*, p. 136.

> vantage would easily lie with Germany, just as it was with Prussia a century ago, when it used the German Zollverein for the purpose of establishing a firm base for future expansion, while Austria-Hungary hovered at the periphery of Germany, undecided until too late where its main interests lay. Read Britain for Austria-Hungary and European Economic Community for the Zollverein, and despite the inevitable weaknesses of such analogies the similarity is too close for comfort.[1]

In this and the following chapter, our interest is in inquiring further into the reasonableness of two propositions: First, that the Zollverein and the Common Market are comparable institutions, at least in regard to their serviceableness as devices to further the expansionist tendencies of a dominant member; and second, that the Common Market was inspired and is being guided to an important degree by German interests.

Concerning the former, several considerations dramatize the basic differences between the Zollverein and the Common Market. For example, the Zollverein embraced nearly thirty separate political states and principalities, the majority of which were too small to be of much significance separately in the economic world. So large a conglomeration of sovereignties probably could not have been held together long except under the tutelage and eventually the domination

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[1] *Ibid.*, p. 157.

of a single strong power. Besides having clear and undisputed economic superiority over her partners, Prussia occupied a "straggling position across most of central and northern Germany" which enabled her to levy a heavy toll on a large part of the transit trade passing between northern seaports and southern Germany and Austria.[1] As a consequence, states on these routes were given a strong incentive to enter the Zollverein to escape these duties. Prussian leverage, therefore, not only was considerable but was probably indispensable for controlling the centrifugal forces operating in Germany at that time. These conditions are contrasted with those in the Common Market in which there are but six members. Luxembourg, it is true, is very small compared to the others, but since it is virtually part of Belgium for economic considerations, its diminutiveness is not especially significant. Nor can we find a member, not even West Germany, whose size and strategic superiority is comparable to that of Prussia in the Zollverein.

Another consideration which differentiates the Zollverein from the Common Market is its clear identification with the nationalistic aspirations of a people having a common language and culture. Separtist sentiment was a constant

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[1]Strauss, op. cit., pp. 25-26.

hindrance to strengthening the internal bonds within the Zollverein, but at the same time there was a growing conviction among the commercial classes especially, that little progress was possible without the continuance of the Zollverein and that the Germans needed to be united in one nation like most of the other peoples of western Europe. Nor did suggestions to extend the Zollverein to non-German states such as Holland, Switzerland, Belgium and Denmark, elicit a favorable response from Prussian leaders. Sound economic arguments for extending the customs union to these nations probably could have been made, but Prussian statesmen believed that the Zollverein should continue as a peculiarly German institution.[1]

In contrast, the Common Market is identified with no one nationality and must therefore depend for its cohesion on a willingness of the populations of the member states to submerge traditional national loyalties. No less important in securing its acceptance by these diverse peoples is perhaps a widely held belief that a higher material welfare is more likely to result if their separate national economies are integrated into a single European economy. All countries in the Common Market possess governments which are popularly

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[1]Henderson, The Zollverein, p. 339.

supported, and this, too, is in contrast with the earlier state of affairs in nineteenth century Germany in which few of the governments were regularly accountable to the people. Apparently the institutions of the Common Market now have to have the backing of a majority of the people in each of the six countries. Any other conclusion would appear to be incompatible with the stability of these institutions.[1]

Another point of significance in contrasting the Common Market with the Zollverein is that the former was founded by a formal treaty in which the participating nations deliberately planned the integration of their separate economies. Furthermore, political unification, though not attempted or even suggested by the Treaty of Rome, was regarded as a desirable goal by a number of European leaders if economic integration could be made to succeed. Political unity in Europe will probably be difficult to achieve, but public statements of quite a few of the prominent leaders of the Common Market countries indicate that they still look

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[1]There is no intention to suggest that this may continue to be true. If recent actions by the French government reflect the feeling of a majority of the French people, their acceptance of Common Market developments may be coming to an end.

upon it as something worth working and planning for.[1] For the most part, this desire for political unity was not felt by the rulers of the member states of the Zollverein. We have seen that there was frequently a great reluctance on the part of the German states other than Prussia to join and stay in the Zollverein. They chafed under Prussian leadership and even went to war with Prussia while the Zollverein continued to function. To relinquish their sovereignty and perhaps to lose their identity in a unified German nation seems not to have been something which was welcomed by the member states.

These considerations seem to weaken appreciably the

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[1]Two of many examples may be cited. "A political union is bound to come. The Common Market is merely a preliminary step to such a union. The Market has already penetrated so deeply into the life of Europe that further union is, in my opinion, inevitable." --Konrad Adenauer, in Look magazine, XXVII, No. 25, p. 28. "Do I need to add that, from the political viewpoint even more, the merger [of the European Communities], by giving new impetus to economic cooperation, cannot fail to have fruitful consequences for what continues to be our goal, I mean the political union of Europe." --French Minister of Foreign Affairs Maurice Couve de Murville, before the French National Assembly, October 29, 1963. Quoted in European Community, No. 67, (Washington, D. C.: European Community Information Service, 1963), p. 12. It must be conceded that the term 'political union' is a rather elastic concept, meaning different things to different people. It has begun to appear that the conception of political union held by French government leaders may vary by a wide margin from what other European leaders have in mind.

case for drawing a close analogy between the Zollverein and the Common Market, at least in the manner in which Strauss has done.

The Situation of Austria and England Compared

We have seen that Austria sought to join the Zollverein on more than one occasion in order to bolster her fading position in Germany. A cardinal principle of Prussian policy was to exclude Austria, the obvious reason being that she did not want a rival for her dominant role. In the present day, England at times has acted as though she wants in the Common Market to avoid further exclusion from Europe, though many of the British apparently are not convinced that it would be to their country's benefit. On at least one occasion Britain began formal negotiations with the Common Market nations on terms of entry, but the discussions hardly got off the ground due to French objections. At these discussions Germany was one of Britain's advocates. In the Common Market, therefore, Germany has acted in a manner just the opposite of Prussia's manner in her treatment of Austria with respect to the latter's quest for Zollverein membership.[1]

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[1] France's behavior has more nearly resembled that of Prussia, but her reasons may have been entirely different.

Summary

The differences between the Zollverein and the Common Market may be summarized under the following points.

(1) The Zollverein brought under one common customs administration as many as thirty separate states and jurisdictions, most of which in time came to accept the Prussian tariff, customs laws and procedure.[1] It was largely a creature of Prussia and very probably could not have been held together except by Prussian pressure and persuasion. The Common Market, on the other hand, is made up of only six states and shows no comparable concentration of economic power, though West Germany is clearly the leading member.

(2) The Zollverein was pre-eminently a German institution and as such derived some support from elements within Germany which were strongly in favor of German unity. Yet it had no broad base of support from the masses simply because there was no electorate having an effective voice. The member states of the Common Market are representative democracies with more diverse traditions and cultures. Its continuance and permanence therefore is more dependent on the mass support of the voting populations of these states,

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[1]Strauss, op. cit., p. 25

a condition which makes it more difficult for any member to control and dominate the Community.

(3) The legal basis for the Zollverein was treaties between the members which ran for specified periods of time and had to be renewed, usually every eight years.[1] The customs union was the Germans' answer in the economic field to their political disunity and an expedient for preventing that disunity from crippling their internal trade. For many years there was little serious effort to create national unity in a political sense. The Common Market, on the other hand, was founded by a single treaty of indefinite duration which programs the progressive integration of the member states' economies. European leaders involved in it have not shrunk from openly advocating the eventual conversion of the Common Market into a political federation.[2]

Presumably this does not exhaust the possibilities in contrasting the Zollverein with the Common Market. The

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[1]Passant, op. cit., p. 68.

[2]Walter Hallstein, president of the Common Market Commission, recently stated the direction in which he thought the European Economic Community was moving, as follows:"There is . . . another more important feature of integration, by which it is akin to federation: it is a dynamic concept, that is to say its very implementation constantly creates new reasons for widening the field of integration." --Community Topics 17 (European Community Information Service, 1964), p. 8.

differences mentioned are only those which have a bearing on the problem which is the subject of the study. I have not intended to imply that these two institutions are in no way comparable, something which is manifestly not true. Both were founded first as customs unions to which other features were added. What began as a movement to free trade among separate states within a well-defined region, in the one case became after thirty-seven years a new nation state, and in the other has brought the western tier of the continent of Europe a little closer to political federation than it has ever been before.

In the next chapter we explore further aspects of the Common Market's development with special reference to the main proposition under study.

CHAPTER III

THE EUROPEAN COMMUNITY:

A COOPERATIVE EFFORT

Before presenting and analyzing data in the fields of balance of payments and trade, it may be appropriate for the purpose of the study to review briefly the events which led up to the organization of the European Economic Community. The purpose here will be to find whether there is any ground for believing with Mr. Strauss that the Common Market plan was fated, perhaps by design, to enhance what was thought to be the already dominant position of the West German economy. Mr. Strauss observes that, "The unmistakable power centre of the new block is the German Federal Republic directed by the rulers of German industry, which has successfully harnessed the urges and aspirations of the dominant social forces and the hopes and fears of many people in Western Europe to the service of a combination promising to be of great benefit to Western Germany in general and to its business interests in particular."[1] He further notes that "the failure of earlier American-inspired attempts at [European] economic integration makes it clear that this force must act from the centre of the area and not on its periphery; and the fundamental difference between the present scheme and earlier plans is the existence of such a force in the shape of Western Germany under its present very able business leadership."[2]

Initiative by Holland and Belgium

If these views are substantially correct, one would presumably expect to find that the Germans were unusually active in initiating and promoting discussions which led to the Common Market Treaty. Mr. Strauss, however, notes earlier that at the Messina Conference of the six member states of the European Coal and Steel Community (formed in 1952) "the representatives of Holland and Belgium took the formal initiative which led to the agreement on the formation of a general common market between these countries."[3] We are

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[1] Strauss, *op. cit.*, p. 7.

[2] *Ibid.*, p. 20.

[3] *Ibid.*, p. 19.

caused to wonder why these two smaller but relatively industrially advanced nations should have elected to push for an enlargement of the Coal and Steel Community into a general common market if it was destined to be a threat to their own industries, uncompensated by other advantages.[1] Both the Dutch and the Belgians, according to Strauss, are "trading partners par excellence whose economies are dominated by the needs of their foreign trade."[2] Small countries such as these, which must live by their trade to a greater degree than their larger neighbors, are almost invariably low-tariff nations. Consequently, membership in a customs union more extensive than that already in existence between themselves (Benelux) would serve to assure them of access to vital markets, an advantage which in their case would hardly be considered unimportant. Strauss says as much when he mentions that "Their main interest in the common market lies in the consolidation

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[1]Belgium had a good example before it at that time of what a common market can do to some of a nation's industries. Some of its coal mines were being gradually shut down as the result of increased competition from more efficient German mines following the inauguration of the Coal and Steel Community in 1953. However, it was expected that this would happen, and plans were made by the Community to ease the adjustment. See J. E. Meade, H. H. Liesner and S. J. Wells, Case Studies in European Economic Union (London: Oxford University Press, 1962), pp. 288-309.

[2]Strauss, op. cit., p. 85.

of their trading areas for which Benelux provided little more than a start." He says next that "The very urgency of this conception for their economic future . . . limits their area of manoeuvre compared with that of larger countries less vitally concerned in the success of the scheme."[1]

It would be a great oversimplification to assume merely because the Benelux countries took the formal initiative in the negotiations that it was through their design that the Common Market Treaty was adopted. In the years before the adoption of the Treaty of Rome a number of dedicated statesmen representing every nation which later joined the Common Market worked towards a solution of the problems of Europe through greater cooperation among its nations.[2] Their efforts finally began to mature in 1953 with the founding of the European Coal and Steel Community. The movement received a temporary setback in August 1954, when the French failed to ratify the newly projected European Defense Community. But less than a year later, in June 1955, came the Messina

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[1] Ibid.

[2] Three excellent accounts of movement for European cooperation are given in Henderson, The Genesis of the Common Market, pp. 131-70; Richard Mayne, The Community of Europe (New York: W. W. Norton & Co., 1962), pp. 68-131; and Walter Hallstein, United Europe, Challenge and Opportunity (Cambridge: Harvard University Press, 1962), pp. 6-29.

Conference which authorized the committee of national representatives to work on a plan for a general common market. The so-called Spaak Report, on which the Common Market Treaty was largely based, was finished in April 1956 and adopted by the ministers of the six nations as a basis for negotiating a common market treaty. After less than a year of negotiations by the national representatives, the Treaty was signed on March 25, 1957. On January 1, 1958, the Treaty went into effect, having been formally ratified by the governments of the six members. Hallstein says that the speed of the achievement attests not only to the ability of the men responsible but also to the power and appeal of the postwar European idea.[1] It also suggests that both among the negotiators and the parliamentary delegations there was a sense of urgency that the future of their nations and of Europe was bound up with the success of efforts to achieve greater cooperation.

Broadly Based Movement

In reading accounts of the movement for European economic integration we find no suggestion that Germans had any more influence than the statesmen and representatives of other European nations. Leadership in the movement seems to have

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[1] Hallstein, op. cit., p. 16-17.

been very well shared. It might even be reasonably argued that the Germans contributed fewer than their proportionate share to a list of these five or six names most prominently identified with the formation of the European Communities in general and the Common Market in particular. For example, the Coal and Steel Community was based on the Schuman Plan, named for Robert Schuman, France's foreign minister in 1950, whose later life was dedicated to the "elimination of the age-old opposition between France and Germany."[1] The man often given most credit for the founding of the Common Market is another Frenchman, Jean Monnet. Monnet served as the first president of the High Authority of the Coal and Steel Community. On resigning this post after the collapse of the European Defense Community proposal, he organized the Action Committee for the United States of Europe, an organization that, according to Mayne, did outstanding work in mobilizing public and official opinion in support of the Common Market Treaty.[2] Serving with Monnet on the Committee were such prominent national party leaders as Erich Ollenhauer, the German Socialist; Maurice Faure, of the French Radical Party; and

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[1]Hallstein, op. cit., p. 10.

[2]Mayne, op. cit., p. 110.

Guy Mollet, the French Socialist leader.[1] The chief architects of the Spaak Report were the forceful Belgian Socialist leader, Paul-Henri Spaak; the Frenchman, Pierre Uri; and Dirk Spierenburg, a Dutch representative on the High Authority of the Coal and Steel Community.[2]

Concessions to France

As we saw earlier, Holland and Belgium took the formal initiative in opening negotiations which eventually led to the adoption of the Common Market Treaty. The negotiations themselves, though consummated in a remarkably short time considering the sharp differences which had to be compromised, were not without difficulty.[3] The country which is regarded by several economists as having gained the most concessions from the bargaining was France.[4] For example, the Treaty conferred association status on a number of colonies and former colonies of the six members and set up a Development Loan Fund of $581.25 million to aid these states, mostly

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[1] _Ibid._, p. 110.

[2] _Ibid._, p. 108.

[3] _Ibid._, p. 109.

[4] See, for example, Mayne, _op. cit._, pp. 122-23, and _Henderson, The Genesis of the Common Market, p._ 158.

in Africa.[1] But most of these non-European associates were dependencies or former colonies of France, very few had links with Belgium, Holland or Italy, and none was a dependency of Germany. Germany, however, made as large a contribution to the Fund as France. Another important provision which the French fought for and secured was one which set as its objective the "progressive harmonization" of economic and social policies such as those having to do with the length of the workweek and overtime wage rates. If harmonization of these policies is carried out, it would result in the raising of production costs in the member countries other than France and thus would confer at least some temporary competitive advantage on French exports.[2]

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[1]A second association convention went into effect June 1, 1964. It creates a free trade area between the six EEC members and the associated states while retaining some protection for the developing industries of the African associates. The associates benefit from intra-Community reductions in tariffs and the elimination of quotas. In addition, certain tropical products now enter the EEC duty free. The African associates will eliminate customs duties, quantitative restrictions, and certain taxes on imports from EEC countries except in cases where an influx of imports might endanger their infant industries. The associates also benefit from financial and technical cooperation.--Undated information bulletin (European Community Information Service).

[2]The principle of harmonization of the type envisioned in the Common Market has been criticized as unsound by some economists. See Bela Balassa, The Theory of Economic Integration (Homewood, Ill.: Richard D. Irwin, Inc., 1961), p. 214.

Some Criticism in Germany

Given German membership in the Common Market, we must assume that German leaders, in general, have believed the arrangement to be not unfavorable to Germany's future development. There was a body of opinion in Germany, however, which found much fault with the plan and voiced serious reservations about it at various times. The most influential and articulate critic was Ludwig Erhard, at that time the economics minister and the present chancellor. We are told by Emile Benoit that any dissension which the formation of the European Free Trade Association was intended by some of its leaders to create among the EEC nations had its most telling effect on the weakest spot in the Community's solidarity, i. e., elements in the German business community, for whom Dr. Erhard served as spokesman, which had always been lukewarm toward the Common Market.[1]

This may be verified by reading some of Erhard's statements. For example, in an article in the Frankfurter Allgemeine Zeitung of December 31, 1959, he criticized the pressure for harmonization of social policies advocated by

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[1] Europe at Sixes and Sevens (New York: Columbia University Press, 1961), p. 86.

some Europeans: "Perhaps it is fear of the incalculable, of something quite unforeseeable happening on the road to European integration that explains why so many of these 'social mechanics' are constantly appealing for 'harmonization'".[1] "The misconceived word 'harmonization' must mean that national economies, joined together in a common effort, must accept the worst economic, financial and monetary blunders committed by any one partner as binding upon all, instead of accepting a corporate obligation to eradicate such weaknesses."[2] "To shape the future one must be able to see the present in its full context, in terms of its dynamic forces and its development trends, and one must know how to exploit these. The 'urge to organize and harmonize', on the other hand, leads almost certainly to disaster."[3]

With reference to the growing concern over the separation of Europe into two rival trade blocs, Erhard said:

> I shall always be in favour of a rapprochement and the removal of all discrimination inside free Europe . . . Until now the situation has not taken a dramatic turn, for the lowering of tariffs within the two

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[1]Ludwig Erhard, The Economics of Success (Princeton, N. J.: D. Van Nostrand Company, Inc., 1963), p. 265.

[2]*Ibid.*, p. 266.

[3]*Ibid.*, p. 267.

> economic areas has only just begun. The damage has not yet become fully apparent. But no one will ever convince me that the developments set in motion by the Common Market will only bring material changes in trade ... . The inherent logic of two separate economic units must lead to a widening of the gap between them . . . This is a trend which must on no account be allowed to continue. And it is my firm conviction that it will not continue. I admit that Germany's position in the world economy does not permit her the luxury of isolation, but I believe that a country like Austria is still less able to afford it.[1]

These statements by Erhard indicate at that time profound misgivings about the operation of the Common Market both in its internal and external effects. According to his premises, balance in payments among the members of a customs union in which each state has its own currency and monetary policy can best be maintained by mobility of

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[1] Ibid., p. 339. Concern for the effect on European trade of a continuation of two trade blocs has been voiced by some national leaders among the European Free Trade Association nations. Recently in a speech in Paris, Knut Hammerskjold, Deputy Secretary General of EFTA, is quoted in the EFTA Reporter as follows: " . . . the refusal by France in January, 1963, to allow Britain and, in consequence, some of her partners to enter the Common Market created a situation which, in its essentials is still with us today . . . We are, in short, faced with a stalemate regarding a possible merger of the two trading groups." --EFTA Reporter, Feb. 8, 1965. Hallstein emphatically disputes that EEC policies have deepened the division or that the EEC nations have shown a lack of concern about the future of European and world trade. "The Treaty of Rome pledges the Community to a liberal commercial policy . . . Its own interest guides it in the same direction." --Community Topics 17 (European Community Information Service, 1965). The statesmen of both the EEC and EFTA place great importance on the outcome of the Kennedy Round of trade negotiations.

resources, monetary discipline, and the maintenance, rather than the avoidance, of the competitive principle. Harmonization as it is commonly conceived would, according to Erhard and kindred minds, hamper the growth of intraregional trade and at the same time could convert the union into a more and more exclusive group having a reduced volume of trade with the rest of the world.

If these opinions are representative of the thinking of more than one influential German -- and it is implausible to think they would be narrowly shared by a very small group if they were held by the economics minister -- they indicate an absence of enthusiasm, at least among some Germans, for the way in which the Common Market was constituted. Such a lack of enthusiasm would be out of keeping with the proposition that Germans exercised more than their proportionate share of influence in the promotion and adoption of the Common Market Plan.

Summary

In this chapter we have seen that the Common Market was launched, as we would expect, through the cooperative efforts of the leaders of the several nations involved. There seems little reason to think that the Germans had an undue amount of influence on its construction. A case may even be made, perhaps, for the proposition that the French exercised the greatest influence: a number of their leaders were at the forefront in the integration movement, and concessions won by France in the actual negotiations were by no means insignificant.

In the next chapter we begin to look at some recent statistics for objective evidence of the presence or absence of undue benefits for Germany in the gradual effectuation of the Common Market as well as for evidence of adverse effects experienced by any of her partners.

CHAPTER IV

BALANCE OF PAYMENTS

As an analytical device for detemmining the effect of the inauguration of a common market on its members, the balance of payments is much less than adequate. This is due to the fact that it summarizes a nation's payments position not with its partners but with the world. Nevertheless, the balance of payments can provide clues which can then be verified or eliminated by resorting to other kinds of data that may be more narrowly confined to intramarket trade relations or more specific in their emphasis. Accordingly, this chapter is devoted to a brief analysis of the balance of payments of the European Common Market member states and Greece since 1958.[1]

What, in general, can we say about the balance of payments effects, either adverse or favorable, of newly acquired membership in a common market? It is reasoned that in the

[1]Greece now has "associate" status with the Common Market.

case of a member state adversely affected by common market membership, one kind of evidence might be a persistent deficit in its balance of payments. The process that would bring this condition about would be something like the following: As trade was increasingly liberalized and the member's industries subjected to the competition of the generally more efficient industries of its partner(s), the member's economy would suffer a decline in employment and economic activity. In an effort to counteract the decline, it is quite reasonable to expect that the member's central bank, either on its own initiative or at the instance of governmental leaders, would adopt an expansionary monetary policy and the central government budget itself would show a considerable deficit. In any case, such policies in the presence of fixed exchange rates would cause within a brief time a more than temporary external deficit -- longer than temporary because the conditions which originally initiated the process are of a structural nature and subject to very slow alteration.[1] Note, of course, the necessity of the assumption that the money supply and hence money incomes in the state adversely affected are expanded (or at least maintained) as a compensatory measure, rather than the reverse assumption of a contraction of the

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[1]The deficit would persist unless the money supply was contracted to lower domestic demand for foreign goods.

money supply by the monetary authorities. (The latter policy, some might still contend, is the one called for under the given conditions and that actually followed, it is said, under the gold standard.) A nation, of course, may develop an external deficit, and rather quickly, if it is on fixed exchange rates, even in the absence of structural difficulties, provided its policy makers have adopted a sufficiently expansionary monetary policy.[1]

We could not, therefore, immediately conclude that a large deficit was solely or even primarily due to the adverse effects of participating in a plan for regional economic integration. The most that can be said is that an uncomfortably large deficit, one lasting more than a year, establishes the presumption that a regional economic union of recent origin may have contributed to the decline in the economy of the member state experiencing the deficit. By a reverse kind of reasoning it could be inferred that a persistent surplus was tentative evidence that a member state might be reaping exceptional rewards from its participation. In neither case, however, could it be conclusively said the balance of pay-

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[1]D. H. Robertson once wrote in an article entitled, "The Economic Outlook", that if absolutely set upon it, any country can create an adverse balance of payments for itself within half an hour. <u>Economic Journal</u>, December, 1947.

ments disequilibrium was definitely and exclusively the result of being a part of a newly formed customs union or common market. Such a finding would have to be confirmed by other evidence.

Overall Balance of Payments

Table 1 summarizes the main features of the balance of payments of the European Common Market member states, plus Greece. The figures are in millions of United States dollars; the classification is that of the International Monetary Fund. For the purpose of determining approximately the condition of the overall balance, the two last columns are the significant ones. Minus figures in these columns, though debit items, signify a surplus condition in the overall balance of payments, inasmuch as these entries represent accommodating monetary movements, and if negative, offset surplus credits in the other accounts. Positive figures in these columns, on the other hand, offset an excess of debits in other accounts, and must be considered indicative of a deficit condition in the overall balance.

Table 1 discloses that the German overall balance has shown a strong surplus in three years, (1958, 1960 and 1963), moderate surpluses in 1961 and 1964, and moderate deficits in 1959 and 1962. For the seven-year period the

TABLE 1

SUMMARY BALANCE OF PAYMENTS STATEMENTS[a]

(In millions of dollars)

	Mdse Trade[c]	Invisibles[b]	Currnt Acct	Cntrl Govt Trnsfr Pmnts	Non-Monetary Sectors' Capital: Private	Non-Monetary Sectors' Capital: Cntral Govt	Net Errors & Omsns	Monetary Sectors' Capital: Privt Instns	Monetary Sectors' Capital: Cntral Instns
Belgium-Luxembourg									
1958	90	284	374	..	-76	74	-4	30	-398
59	-48	136	88	-16	-32	-80	-16	-48	104
60	14	146	160	-50	-50	100	-34	28	-154
61	-40	134	94	-42	60	-116	14	218	-228
62	..	124	124	-28	4	-48	28	-118	38
63	-66	38	-28	-54	24	42	12	204	-200
64	-22	32	54	-48	178	24	8	40	-256
Franc Area									
1958	-211	-80	-291	117	215	-96	-16	-129	200
59	405	327	732	-20	481	-133	111	386	-1,557
60	-20	632	612	-38	304	-173	-4	-14	-687
61	371	589	960	43	323	-110	54	122	-1,392
62[d]	347	411	758	37	417	-656	29	102	-687
63[d]	177	245	422	89	444	-429	128	202	-856
64	-178	96	-82	62	431	-83	449	38	-815
Germany									
1958	1,787	12	1,799	-375	-124	-206	-95	-175	-824
59	1,846	-158	1,688	-702	-254	-806	-25	-304	403
60	2,043	-226	1,817	-715	394	-482	400	537	-1,951
61	2,429	-758	1,671	-983	360	-1,239	108	-66	150
62	1,717	-1,126	591	-1,144	364	-265	231	-35	258
63	1,469	10	1,459	-1,239	784	-376	-132	172	-678
64	1,421	-113	1,308	-1,205	89	-492	470	13	-183
Italy									
1958	-373	946	573	-9	174	-12	37	143	-906
59	-133	925	792	-37	262	31	-199	48	-897
60	-634	1,006	372	-55	310	41	-232	-268	-168
61	-556	1,108	552	-44	500	29	-463	40	-614
62	-880	1,211	331	-53	451	-184	-685	430	-290
63	-1,808	1,182	-626	-32	934	-37	-1,511	650	622
64	-580	1,265	685	-25	995		-875	-443	-337

TABLE 1--Continued

	Mdse Trade[c]	Invis-ibles[b]	Currnt Acct	Cntrl Govt Trnsfr Pmnts	Non-Monetary Sectors' Capital Private	Non-Monetary Sectors' Capital Cntral Govg	Net Errors & Ommsns	Monetary Sectors' Capital Privt Instns	Monetary Sectors' Capital Cntral Instns
Netherlands									
1958	32	399	431	-16	198	-133	22	-16	-486
59	19	469	488	-21	-19	-98	-60	-354	64
60	-116	488	372	-25	106	-41	27	-70	-369
61	-347	568	221	-41	-82	-89	33	38	-80
62	-279	467	188	-47	-29	-70	-60	-1	19
63	-443	525	82	37	13	-103	151	-13	-167
64	-199	154	-45	..	54	-9	15	53	-68
Greece									
1958	-284	189	-95	17	52	7	2	4	13
59	-242	197	-45	34	43	22	..	-2	-52
60	-310	224	-86	28	40	25	2	-5	-4
61	-350	262	-88	24	58	45	-12	-2	-25
62	-447	330	-117	32	103	10	4	-2	-30
63	-452	374	-78	30	105	7	-9	-38	-17
64	-573	363	-210	6	137	68	-17	7	10

[a]Compiled from IMF, International Financial Statistics, XVIII, No. 6, and IMF, Balance of Payments Yearbooks 15 and 16.

[b]Includes freight and merchandise insurance and other services, investment income and private transfers except as follows: For Franc Area and Germany in 1963 and 1964 private transfers are included with central government transfers.

[c]F.O.B. except C.I.F. for Germany in 1963 and 1964.

[d]Entries for 1963 and 1964 are for metropolitan France.

German net surplus reported to the Monetary Fund was $2,683 million. It is interesting to note, however, that over the six-year period, 1959-64, the surplus for the French Franc Area was $5,087 million. Nor can the German surplus for the seven years in itself be considered remarkable compared with those of the other nations. They are as follows (figures in millions): Belgium-Luxembourg, $740; Italy, $1,990; Netherlands, $1,450; Greece, $143.

The overall balance by itself, however, conceals important details. It does not show, for example, the primary or secondary origins of a surplus or deficit. These can only be discovered by examining the main accounts separately.

Germany

Table 2 fills in more of the details of the German balance of payments. We see that Germany's overall surplus was achieved despite an outflow of funds in the form of government transfer payments in the neighborhood of $6 billion and a net capital outflow, mainly the result of government loans, amounting to $2,244 million.[1] That a sizable overall surplus could have been recorded while so large an outflow

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[1]The figure given here for government transfers is an approximation based on an estimate of $1,100 million each for the years 1963 and 1964. The Monetary Fund tables do not separate private and government transfers for these years.

TABLE 2

GERMANY: BALANCE OF PAYMENTS 1958-64[a]
(In millions of dollars)

	1958	1959	1960	1961	1962	1963	1964
Trade balance[b]	1,787	1,846	2,043	2,429	1,717	1,469	1,421
Services							
Services to foreign troops	857	908	976	956	1,075	1,072	1,055
Investment income	-139	-237	-189	-328	-328	..	..
Other	-631	-758	-922	-1,267	-1,735	-1,082	-1,168
Net services	87	-87	-134	-639	-988	-10	-113
Net goods & services	1,874	1,759	1,909	1,790	729	1,459	1,308
Transfer payments							
Private	-75	-71	-92	-119	-138	..	..
Central government[c]	-375	-702	-715	-983	-1,144	..	..
Net transfer payments	-450	-773	-807	-1,102	-1,282	-1,239	-1,205
Autonomous capital accounts							
Direct investment	-93	21	1	10	-97	793	89
Other private	-31	-275	393	350	461		
Repayments under London debt agreement	-102	-312	-70	-796	-21	-376	-492
Other official	-104	-494	-412	-443	-244		
Net official and private	-330	-1,060	-88	-879	99	417	-403
Monetary gold (Increase -)	-98	2	-334	-689	-16	-165	..

[a]Compiled from IMF, International Financial Statistics, XVIII, No. 6 and IMF, Balance of Payments Yearbooks 15 and 16.

[b]F.O.B. for 1958-62; C.I.F. for 1963 and 1964.

[c]Made up largely of reparations to Israel and other indemnifications.

of funds in the form of transfers and exports of capital was underway indicates the basic competitive strength of the German economy. This is shown directly in the seven-year surplus in the current account of approximately $10 billion.

There were, however, two factors which possibly operated to the advantage of the German economy. One of these was largely unrelated to the competitiveness of the economy; the other allegedly enhanced its competitiveness. The first factor was in the form of large receipts for services to foreign troops and military agencies, amounting to approximately $6.9 billion. The greater part of these earnings were paid by the United States Government. How much the German overall balance of payments surplus would have been without these credits cannot be known. But it seems reasonable to believe that in their absence, it would have been reduced materially.

The other factor which supposedly operated in favor of a high volume of German exports was an official price for the deutsche mark which in effect, it was said, undervalued it.

The mark was revalued upward by 5 per cent, from 23.8095 cents to 25 cents, on March 5, 1961. The revaluation is viewed as a step in recognition of the mark's previous alleged undervaluation, a situation conducive to a balance of payments surplus.[1] The effect of this action is difficult to assess, although in 1961 Germany continued to run a surplus in its external accounts, albeit by a smaller amount, and in 1962 there was a deficit. Next year the accounts again showed a surplus. Export prices probably tend to adjust in a relatively short time to a change in a currency's official rate of exchange, so that a revaluation will not long handicap an economy which for some underlying reason is tending to surpluses. The matter is further obscured when we take into account that a rise in prices and incomes in other countries will necessarily alter the effects which would have followed from revaluation of one country's currency.

According to one point of view, Germany tended to run an embarrassingly large surplus more or less continuously prior to the revaluation because the mark was undervalued, which had the effect of giving German exports an additional competitive advantage. It is possible, however, to reverse

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[1]The revaluation was one of a series of complex measures adopted by the government and the central bank to correct the large balance of payments surplus of 1960, to discourage speculative capital movements into the country and at the same time to encourage a capital outflow. --See Annual Report (IMF, 1962), pp. 92-94.

the above cause and effect relationship as follows: The mark was a strong currency and appeared to be undervalued because Germany had a fairly consistent balance of payments surplus. All things considered, it would seem that a change in its currency's par value can work to the advantage or disadvantage of a trading nation's payments position for only a relatively brief time. Export prices will tend to adjust to the new situation. If a surplus again develops for other reasons, the currency's official value will again appear to be low. We thus arrive at the tentative conclusion that the mark's par value prior to 1961 might not have been the major factor causing Germany's surpluses, but that the revaluation of March 1961 possibly contributed temporarily to the slackening of these surpluses and to the deficit of 1962.

France

The entries in Table 1 pertaining to France are in reality applicable to the entire French Franc Area. The Franc Area includes, in addition to metropolitan France, the French Overseas Departments and Territories and a number of countries which were formerly under French control but have become independent in recent years. Table 3 shows the net contribution of the Overseas Franc Area in each year except 1958. All the other entries reflect the transactions of metropolitan

TABLE 3

FRANCE: BALANCE OF PAYMENTS 1958-64[a]
(In millions of dollars)

<table>
<tr><th></th><th>1958</th><th>1959</th><th>1960</th><th>1961</th><th>1962</th><th>1963</th><th>1964</th></tr>
<tr><td>Trade balance[b]</td><td>-211</td><td>435</td><td>92</td><td>417</td><td>501</td><td>177</td><td>-178</td></tr>
<tr><td><u>Services</u></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Travel</td><td>..</td><td>..</td><td>237</td><td>216</td><td>198</td><td>121</td><td>23</td></tr>
<tr><td>Government</td><td>..</td><td>..</td><td>164</td><td>172</td><td>92</td><td>94</td><td>70</td></tr>
<tr><td>Investment income</td><td>..</td><td>..</td><td>42</td><td>25</td><td>50</td><td>66</td><td>..</td></tr>
<tr><td>Other</td><td>..</td><td>..</td><td>138</td><td>82</td><td>-17</td><td>-36</td><td>3</td></tr>
<tr><td>Net services</td><td>-80</td><td>275</td><td>581</td><td>495</td><td>323</td><td>245</td><td>96</td></tr>
<tr><td>Net goods & services</td><td>-291</td><td>710</td><td>673</td><td>912</td><td>824</td><td>422</td><td>-82</td></tr>
<tr><td><u>Transfer payments</u></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Private</td><td>..</td><td>..</td><td>46</td><td>96</td><td>115</td><td>..</td><td>..</td></tr>
<tr><td>Government</td><td>117</td><td>..</td><td>-85</td><td>-55</td><td>-95</td><td>..</td><td>..</td></tr>
<tr><td>Net transfer payments</td><td>..</td><td>31</td><td>-39</td><td>41</td><td>20</td><td>89</td><td>62</td></tr>
<tr><td><u>Autonomous capital accounts</u></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Direct investment</td><td rowspan="2">215</td><td rowspan="2">403</td><td>63</td><td>76</td><td>202</td><td>118</td><td rowspan="2">431</td></tr>
<tr><td>Other private</td><td>176</td><td>207</td><td>86</td><td>326</td></tr>
<tr><td>Government[c]</td><td>-96</td><td>-274</td><td>-354</td><td>-440</td><td>-722</td><td>-429</td><td>-83</td></tr>
<tr><td>Net capital</td><td>119</td><td>129</td><td>-115</td><td>-57</td><td>-434</td><td>-15</td><td>348</td></tr>
<tr><td>Net transactions of Overseas Franc Area with Non-Franc Area</td><td>..</td><td>59</td><td>-12</td><td>89</td><td>117</td><td>132</td><td>245</td></tr>
<tr><td>Monetary gold (increase -)</td><td>..</td><td>-540</td><td>-352</td><td>-480</td><td>-466</td><td>-588</td><td>-555</td></tr>
</table>

[a]Compiled from IMF, International Financial Statistics, XVIII, No. 6, and IMF, Balance of Payments Yearbooks 15 and 16.

[b]F.O.B.

[c]Includes advance debt redemptions of (in millions of dollars) 185 in 1960; 320 in 1961; 583 in 1962; and 281 in 1963.

France with the rest of the world other than the Franc Area. The total net contribution of the Overseas Franc Area for the years 1959-64 was $630 million. Subtracting this from the overall Franc Area surplus of $5,087 million as derived from Table 1, this gives an overall surplus for metropolitan France of $4,457 million, which is $1,774 million greater than the German overall surplus for the same years. This large payments surplus, which was pulled down by advance debt redemptions totaling $1,369 million, was made possible by continuous surpluses in the current account from 1959 until 1964. Otherwise, France benefited from net private foreign investment totaling $2,303 million.

Probably very few, if any, students of the French economy would have predicted this favorable payments record. Just prior to the time the Treaty of Rome began to be implemented France's ability to live with the Treaty and carry out its obligations was still subject to considerable doubt.[1] The performance of the French economy as reflected in its balance of payments history is probably not due primarily, and may be only incidental, to membership in the Common Market.

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[1]Benoit says the chief worry of many of those following the negotiations was whether France might fail to implement the required tariff cuts as they came due in view of her financial weakness and the opposition of her small business group. Emile Benoit, *op. cit.*, p. 67.

A combination of other favorable circumstances probably had greater weight. Not the least of these was that after years of political and social turmoil which adversely affected its economy, France regained a degree of internal stability soon after the Common Market was inaugurated. A new government ended the costly struggle in Algeria and finally stabilized the franc in December 1958.[1] The nation seemed to achieve a unity of purpose formerly lacking. And as in the case of the other European countries, the size of the surpluses can be attributed in an indeterminable but large degree to the creation of international reserves stemming from the successive deficits in the United States balance of payments.

It should be noted that the French current account was in deficit in 1964 after five continuous years of surpluses. The overall balance was still aided by a net capital inflow of $348 million. The current account weakened under the impact of a steep rise in internal costs, especially in more recent years. Between 1958 and 1964 export prices rose an average of 19 per cent, in part under the influence of

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[1]The stabilization of the franc and eventual restoration of convertibility had much to do with the return of international and domestic confidence in the currency and probably was a factor in helping to coax some foreign private balances back to France.

wage increases averaging 49 per cent between 1958 and 1963.[1] Inflation has not been fully controlled, although "In the course of 1964 great strides were made towards the recovery of economic and financial equilibrium."[2]

Italy

The case of Italy is in part similar and in part different from that of France and Germany. Italy, too, has had a fairly substantial overall surplus for the seven years. But the current account weakened in 1962, as is shown in Table 4, and in 1963 carried a $947 million debit balance. This was only partially offset by net transfer payments of $289 million. The monetary sector capital accounts of Table 1 indicate that the overall deficit was $1,272 million. This appears to be a deficit of much greater than ordinary magnitude. The autonomous capital accounts technically carried a surplus of $897 million, but recognition must be taken of the large item of $1,470 million shown as repatriation of Italian banknotes in Table 4. The origin of this entry is the remittance abroad by Italian residents of Italian bank-

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[1] International Financial Statistics (IMF), XVIII, No. 4, pp. 120-21.

[2] The Economic Situation in the Community (European Economic Community Commission, December 1964), p. 57.

TABLE 4

ITALY: BALANCE OF PAYMENTS 1958-64[a]

(In millions of dollars)

	1958	1959	1960	1961	1962	1963	1964
Trade balance[b]	-373	-133	-634	-556	-880	-1,808	-580
Services							
Travel	411	448	548	647	723	749	825
Investment income	-34	-5	-30	-52	-91	-114	..
Government	95	105	79	59	32	39	..
Other	198	155	153	138	203	187	140
Net services	670	703	750	792	867	861	965
Net goods & services	297	570	116	236	-13	-947	385
Transfer payments							
Private[b]	276	222	256	316	344	321	300
Central government	-9	-37	-55	-44	-53	-32	-25
Net transfer payments	267	185	201	272	291	289	275
Autonomous capital accounts							
Direct investment	109	174	290	97	119	170	..
Other private	65	88	20	403	333	764	..
Government	-12	31	41	29	-184[c]	-37	..
Net capital	162	293	351	529	268	897	995
Monetary gold (increase -)	-620	-663	-455	-22	-18	-100	236
Net errors & omissons	37	-199	-232	-463	-685	-1,511	-875
Repatriation of Italian banknotes	..	-63	-185	-330	-766	-1,470	..
Other errors and Omissions	..	-136	-47	-133	81	-41	..

[a]Compiled from IMF, International Financial Statistics, XVIII, No. 6, and IMF, Balance of Payments Yearbooks 15 and 16.

[b]Includes emigrants' remittances (in millions of dollars) of 188 for 1958; 170 for 1959; 214 for 1960; 261 for 1961; 298 for 1962; and 283 for 1963.

[c]Includes advance debt repayment of $179 million.

notes which are subsequently returned to Italy for redemption.[1] Actually this represents an export of capital, and when so considered, puts the capital account in deficit in both 1962 and 1963.

The immediate cause of the deficits was a sharp increase in imports relative to exports between 1961 and 1963. The index of import volume rose from 182 to 259 (1958 = 100) while that for exports increased from 176 to 207.[2] The increase in the export price index from 92 to 95 between 1961 and 1963, while the import price index rose only from 90 to 91, accounts for the rise in imports relative to exports.[3] Internal inflation was back of this development. It is reflected in an increase in bank credit of 20.8 per cent between 1961 and 1962 and of 20.6 per cent between 1962 and 1963 and in an increase in the index of wages from 109 to 130 between 1961 and 1963.[4]

We must inquire into whether the inflationary upsurge, which evidently started sometime in 1962, was a reaction to

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[1] Annual Report (IMF, 1963), p. 137.

[2] International Financial Statistics (IMF), XVIII, No. 4, 168-69

[3] Ibid.

[4] Ibid.

an unfavorable impact on the Italian economy from intensified competition within the European Economic Community. The evidence of this might be a decline in, or marked slackening in the rate of increase of, both industrial production and manufacturing employment beginning in 1961 and continuing through 1962 and 1963. Index figures for both these are given in Table 5, A slight slackening in their rates of increases is, in fact, indicated, but the likelihood is that it was caused by the approach to capacity levels of operation in many sectors of the economy and by pressure on available productive resources.

TABLE 5

INDICES OF ITALIAN INDUSTRIAL PRODUCTION AND MANUFACTURING EMPLOYMENT[a]

(1958 = 100)

	1958	1959	1960	1961	1962	1963
Industrial production	100	111	128	142	156	169
Manufacturing employment	100	100	107	114	120	124

[a]*International Financial Statistics* (IMF), XVIII, No. 6, pp. 168-69.

The directors of the International Monetary Fund reported in 1963 that unemployment, formerly a factor in maintaining relative stability in Italian wages and prices, had steadily fallen because of the rapid economic expansion in Italy and the large-scale employment of Italian workers in other European countries.[1] Thus the high rate of activity and relatively full utilization of capacity, in the presence of continued rising demand, had much to do with the deterioration in the Italian balance of payments in 1962 and especially in 1963.

It is clear that 1964 was a year of adjustment for Italy in which both the government and central bank were obliged to carry out measures to correct some of the conditions which helped create the massive deficit of 1963. These included a tightening of credit, fiscal measures involving special taxes to reduce consumption, especially of luxury items, stabilization of government expenditures and measures to encourage exports.[2]

Evidently these measures accomplished what they were designed to do. According to Table 1, Italy recorded an

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[1] Annual Report (IMF, 1963), p. 135.

[2] Annual Report (IMF, 1964), pp. 89-90.

overall surplus in its international payments for 1964 along with a respectable current account surplus due to an accelerated rise in exports while the trend in imports was weak.[1]

Belgium-Luxembourg, Netherlands

As noted earlier, both Belgium-Luxembourg and the Netherlands have recorded overall international payments surpluses for the years 1958 to 1964. Belgium-Luxembourg's surplus amounted to $743 million; the Netherlands' was $1,450 million. Table 6 gives the details of Belgium-Luxembourg's balance of payments. The current account has shown considerable variation, recording a $78 million debit balance in 1963 but showing considerable improvement in 1964. The autonomous capital accounts showed increasing surpluses in both 1963 and 1964.

The Netherlands' payments position was especially strong in the first three years of the Common Market, as can be seen both in Table 1 and Table 7. So large had been the payments surpluses from 1958 to 1960, mainly due to heavy credit balances in the current account but also due to an exceptional inflow of short-term speculative capital in 1960, that the guilder was appreciated early in 1961, almost con-

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[1] _The Economic Situation in the Community_ (European Economic Commission, December, 1964), p. 72.

TABLE 6

BELGIUM-LUXEMBOURG: BALANCE OF PAYMENTS 1958-64[a]

(In millions of dollars)

	1958	1959	1960	1961	1962	1963	1964
Trade balance[b]	90	-48	14	-40	..	-66	22
Services							
Freight, transportation and mdse. ins.	56	50	24	-8	10	10	..
Investment income	50	22	46	36	14	-12	-10
Other	154	6	18	46	48	-10	..
Net services	260	78	88	74	72	-12	-28
Net goods & services	354	30	102	34	72	-78	-6
Transfer payments							
Private	20	58	58	60	52	50	60
Central government	..	-16	-50	-42	-28	-54	-48
Net transfer payments	20	42	8	18	24	-4	12
Autonomous capital accounts							
Direct investment and other private	-76	-32	-50	60	4	24	178
Government	74	-80	100	-116	-48	42	24
Net capital	-2	-112	50	-54	-44	66	202
Monetary gold (increase -)	-354	136	-36	-78	-116	-6	-256

[a]Compiled from IMF, International Financial Statistics, XVIII, No. 6, and IMF, Balance of Payments Yearbooks 15 and 16.

[b]Exports f.o.b., imports f.o.b. for 1958-60 and 1964 and partly f.o.b., partly c.i.f. for 1961-63.

TABLE 7

NETHERLANDS: BALANCE OF PAYMENTS 1958-64[a]

(In millions of dollars)

	1958	1959	1960	1961	1962	1963	1964
Trade balance[b]	32	19	-116	-347	-279	-443	-199
Services							
Transportation and mdse. ins.	134	176	229	262	276	275	89
Investment income	86	150	106	166	105	178	56
Other	162	138	124	118	74	69	6
Net services	382	464	459	546	455	522	151
Net goods & services	414	483	343	199	176	79	-48
Transfer payments							
Private	17	5	29	22	12	3	2
Central government	-16	-21	-25	-41	-47	37	..
Net transfer payments	1	-16	4	-19	-35	40	2
Autonomous capital accounts							
Direct investment	-215	-205	-68	-69	-52	-65	54
Other private	413	186	174	-13	23	78	
Government	-133	-98	-41	-89	-70	-103	-9
Net capital	65	-117	65	-171	-99	-90	45
Monetary gold (increase -)	-313	-81	-320	-131	..	-20	-24

[a]Compiled from IMF, International Financial Statistics, XVIII, No. 6, and IMF, Balance of Payments Yearbooks 15 and 16.

[b]F.o.b.

currently with the revaluation of the German deutsche mark, to dampen down inflationary pressures.[1] The revaluation had the expected effect of reducing the payments surplus in 1961, and a small deficit ensued in 1962. Table 7 indicates that the current account surplus dwindled from $199 million in 1961 to $79 million in 1963.

Rather than revalue the guilder, the Dutch authorities might have chosen to leave its par value unaltered. If, then, as the likely result, total exports, including invisibles had continued to be excessive in relation to all imports, causing a continuing rise in foreign exchange and bank reserves, action might have been taken to sterilize part of the increase to combat its inflationary effect. In this case, the rise in national output and income might have been little different from what it actually was, but the economy's export industries would have maintained a competitive advantage somewhat longer. In taking the action they did the Dutch probably reduced to some degree the competitiveness of their exports, at least in the short run.

Greece

The association of Greece with the European Economic

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[1]See Annual Report (IMF, 1962), p. 94.

Community dates only from November 1962. Assessment of the effect of the association on Greece is possibly premature because of the brief period of association. Nevertheless, we note in Table 1 that as far as the balance of payments is concerned, Greece' overall surplus increased slightly in 1962, rose considerably in 1963, but deteriorated in 1964. The Greek overall surplus over the entire period shown is due to a continuous inflow of capital and grants and donations large enough to more than offset an uninterrupted debit balance in the current account.

As time progresses, the association of Greece with the Common Market should provide a test which may throw some light on the question of whether a nation which is both small and relatively underdeveloped can gain or even survive in an economic union in which its partners are either larger or more fully developed, or both. "The Association Agreement . . . lays down that the Greek economy may one day be fully integrated with that of the Common Market. This means a fundamental change in the economic and social life of the country and holds out much promise for the future; it also requires energetic action to develop the Greek economy during the transitional period."[1] It is recognized that Greek

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[1]European Investment Bank 1958-1963 (Brussels: European Economic Community, 1964), p. 44.

development plans will necessitate large injections of foreign capital. Accordingly, EEC aid in the form of a loan of $125 million spread over five years is provided for in the Association Agreement.

International Liquidity

Balance of payments developments are ultimately reflected in changes in the foreign exchange reserves of nations. As we would expect in view of the aggregate surpluses which all Common Market members have recorded, their reserves have increased. The total increase for all six members was approximately $9.8 billion. Percentagewise, however, there is considerable variation in the increases of each member, as Table 8 shows. France recorded by far the largest increase in absolute terms and by 1964 possessed reserves second only to Germany's in volume. This is perhaps not inappropriate since France's economy is the second largest in the Common Market.

It would be an oversimplification to attribute France's large increase in reserves to any special benefits derived from membership in the Common Market or to a rapid revitalization of her export industries. The increase grew out of a combination of favorable events, some of which have already been suggested. Among these was a change in monetary

TABLE 8

OFFICIAL GOLD AND FOREIGN EXCHANGE RESERVES[a] [b]

Country	Reserves at end of 1958	Reserves at end of 1964	Increase 1958-64	Six-Year Increase as % of 1963 GNP	Reserves in 1964 as % of GNP
	(Millions of Dollars)				
Belgium-Luxembourg	1,553	2,192	639	4.4	15.2
France	1,050	5,724	4,674	5.8	7.2
Germany	5,879	7,882	2,003	2.1	8.4
Italy	2,127	3,823	1,696	3.8	8.6
Netherlands	1,539	2,349	810	5.6	16.2
Greece	170	281	111	2.5	6.4

[a]IMF, International Financial Statistics, XVIII, No. 4

[b]Includes IMF reserve position.

and fiscal policies which had as their objective the slowing down of the excessive inflation of the early and middle fifties. The inflation of those years had given France a chronic balance of payments problem and shrunk its foreign exchange reserves to abnormally low levels. After the last devaluation of the franc December 27, 1958, imports fell considerably, and gold dishoarding by French residents helped further to reduce the deficit.[1] Inflation has continued in France but not at such a rate as to cause French export prices to be greatly out of line with the prices of other countries' exports. In addition, with a return of internal stability and the lure of its membership in the Common Market, France began to attract an increased amount of American private capital.

To give the increase in each country's reserves additional perspective, Table 8 also shows both the seven-year increase of each country and its total reserves at the end of 1964 as percentages of its GNP for the latest available year. The German ratio of increase in reserves to its GNP is actually the smallest of all. Not too much significance, however, can be attached to this. German reserves in 1958 were probably abnormally high in relation to the reserves of its partners, especially France. They were only $390 million less than the total reserves of all the other members. A perpetuation of this imbalance was hardly to be expected if the Common Market plan was to function at all satisfactorily.

Summary

All EEC nations ran balance of payments surpluses

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[1]*Annual Report* (IMF, 1959), pp. 88-92.

and gained foreign exchange reserves during the 1958-64 period. Germany began with a heavy superiority in terms of volume of reserves. We saw that at the end of the period she still had larger reserves than any of the others, but her partners were relatively in a better position from the standpoint of reserves than they were when the Common Market was inaugurated.

All members had generally satisfactory balance of payments records for the period as a whole. The Italian external balance deteriorated rather rapidly in 1962 and 1963, but there was reason to believe that it was not caused so much by problems created by its membership in the Common Market as by other factors. Principal among these were the excessive strength of internal demand caused by inflationary pressures while the continued expansion of supply became increasingly limited by an approach to capacity utilization of productive resources. This applied particularly to the gradual exhaustion of large reserves of labor which Italy still had in the early years of the Common Market's operation.

Without the increase in international liquidity which has taken place in the recent past, the surpluses of the Common Market countries during this time would most likely have been smaller, and one or more countries might have had overall deficits instead of surpluses. The growth in liquidity, therefore, may conceal certain weaknesses in the competitive position of one or more EEC nation. Data on economic growth and trade are examined in the next chapter for possible insights into this.

CHAPTER V

ECONOMIC GROWTH AND TRADE

In this chapter let us first look briefly at what economic theory has to say concerning the possible effects of customs unions on their members. This will enable us better to interpret the data presented later on.

The theory of customs unions is a highly complex one as is known by those who have read any of the growing number of contributions which have been made to it in recent years.[1] Much thought has been devoted to consideration of the effects of a union on productive efficiency and hence on economic welfare within the union as a whole. These considerations arise because both trade creation and trade diversion take place when a customs union is formed. Trade creation stems from the greater number of profitable opportunities for

[1]The complexity originates in the fact that the establishment of a customs union involves elements both of free trade and protection: free trade within the union, but the maintenance of, and possibly an increase in, protection vis-a-vis the rest of the world.

trade between the partners when customs and other barriers are removed. Diversion results because trade in some products between partners and third countries will be reduced whenever the new common tariff exceeds the tariff formerly imposed by the partners individually on these products. Diversion tends to reallocate resources and production to higher-cost producers within the integrated area. However, since trade creation has the opposite effect, i.e., reallocates resources and production to lower-cost producers within the area, productive efficiency will be enhanced if the amount of trade creation exceeds the amount of trade diversion. Whether this happens will depend in an important degree on the height of the common tariff which is eventually placed on the many products for which an import potential exists in the integrated area. The lower these tariffs are set, the less will be the scope of trade diversion for a given amount of trade creation.

Professor Viner's pioneer work on customs unions advanced what was at that time the novel view that a customs union would have more advantages for a group of countries whose economies were competitive rather than complementary. Competitiveness was described as "correspondence in kind of products of the range of high-cost industries as between the different parts of the customs union which were protected by tariffs in both of the member countries before customs union was established."[1] According to Balassa, "Competitiveness denotes a large degree of overlapping in the range of the commodities produced, and complementarity means substantial differences in the scope of production."[2] He says that, ". . . efficiency is likely to be improved in a customs union of competitive economies, although the beneficial effects will be impaired if the member countries have strong competitors abroad. Finally, if the participating economies were largely complementary, discrimination against third-country producers would lead to negative production effects."[2]

Other beneficial effects of a customs union to its members as a group may derive from (1) the stimulation of more widespread and effective competition through the elimination of monopolistic distortions within the individual

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[1]Jacob Viner, The Customs Union Issue (New York: Carnegie Endowment for International Peace, 1950), p. 51. Prior to this the commonly held view, both among free traders and protectionists, was that a union of complementary economies would offer the greatest natural advantages. See Bela Balassa, The Theory of Economic Integration (Homewood, Ill.: Richard D. Irwin, Inc., 1961), p. 30.

[2]Balassa, op. cit., p. 32. Negative production effects "refer to the extra cost of producing a commodity in the partner country rather than in the foreign country as trade diversion shifts the source of supply from lower cost (foreign) to higher-cost (partner) producers.", p. 27.

economies; (2) an induced increase in the average rate of growth through the stimulation of greater investment which has become profitable in the larger market created; and (3) the possibility of exploiting economies of scale in a larger market.[1]

These last factors fall into the dynamic category and, like the other factors heretofore mentioned, are concerned with the overall effects of economic integration on the region as a whole. A second question (or set of questions) of possibly more recent origin concerns the effect of a customs union or common market on its members individually or on the separate regions which make up the union. Will economic integration always benefit a country, or might its effect under certain conditions be damaging to it? Also, is it possible, while benefits may be secured by all members of a customs union or common market, that these benefits may

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[1]See Harry G. Johnson, "The Economic Theory of Customs Union," Pakistan Economic Journal, X, No. 1, 14-32, reprinted in Harry G. Johnson, Money, Trade and Economic Growth (Cambridge: Harvard Univ. Press, 1962), pp. 46-74; also Balassa, *op. cit.*, ch. 6 and 8. In a recent book, Jaroslav Vanek has pointed out with some logic that if a customs union can bring about these desired effects within the customs area, it is possible that it may have the opposite effects in the rest of the world. That is, if large enough, it may narrow the world market for some products, lower the average rate of growth elsewhere by reducing the profitability of investment, etc. See General Equilibrium of International Discrimination (Cambridge: Harvard University Press, 1965), p. 9.

be shared very unequally, a disproportionately large part of them going to one or two members in a union of, say, five or more members? It is with these questions that we are concerned in this study, with specific reference to the European Common Market.

Criteria for Customs Unions

Two criteria have been given to evaluate customs unions for their potential capacity to benefit their members by making possible a balanced growth of trade between them. It is said that a given customs union or common market has a greater chance of success the nearer alike the partners are in (1) size and in (2) stage of development.[1] If one or two countries are so far superior in one or both these respects as to be clearly dominant, they may prosper at the expense of their partners. The strains which would result would then imperil the success of the union and might cause its dismemberment. We can now evaluate the European Common Market not only according to these criteria but also according to Viner's criterion of competitiveness.

First, using the latter, there seems little doubt

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[1]Charles Staley, "Central American Economic Integration," Southern Economic Journal, XXXIX, No. 2, 88-95; also J. E. Meade, The Theory of Customs Unions (Amsterdam: North Holland Publishing Co., 1956).

that the Common Market countries represent a competitive grouping.[1] One indicator of this is the percentages of the civilian labor forces employed in agriculture, industry and services in the six countries. These are shown in Table 9.

TABLE 9

CIVILIAN LABOR FORCE BY MAIN SECTOR OF ECONOMIC ACTIVITY[a]

(In percentages)

Country	Year	Agriculture	Industry	Services	Unemployed
Belgium	1963	6	45	47	2
France	1963	19	39	40	2
Germany	1963	12	49	38	1
Italy	1963	26	40	31	3
Luxembourg	1960	15	44	41	..
Netherlands	1961	10	42	47	1

[a]Statistical Office of the European Communities, Basic Statistics of the Community (5th ed., Brussels, 1964), pp. 24-25.

Next we compare the economies of the Common Market by their size and level of development. To compare size, we use each country's gross domestic product. Level of

[1]Balassa says "Even a cursory glance at the industrial and foreign-trade statistics of the European Common Market countries would reveal a considerable degree of rivalry in the economic structure of these economies. In addition, a significant part of this union's imports consists of raw materials which cannot be produced inside the Common Market." --The Theory of Economic Integration, p. 33.

development is reflected in per capita domestic product; the higher the level of development, the larger the country's per capita product. These comparisons are given in Table 10.

TABLE 10

GROSS DOMESTIC PRODUCT AND PER CAPITA GDP IN 1958[a]

	GDP Billions of Dollars	Per Capita GDP Dollars
Belgium	9.4	1,040
France	52.3	1,168
Germany	57.3	1,122
Italy	33.8	689
Luxembourg	.4	1,345
Netherlands	11.6	1,038
Greece	2.5	297

[a]United Nations, Yearbook of National Accounts, 1963, p. 329.

Using figures for 1958 (the year the Common Market was organized) the table shows there was considerable variation in size among the six members of the union and Greece. At the extremes, Germany's economy is about six times larger than the economy of Belgium and Luxembourg taken together. The Netherlands' economy is hardly any larger than Belgium-Luxembourg's, while France's economy is not much smaller than Germany's. The Italian economy is about midway in size between the largest and the smallest. There is less variation in terms of per capita domestic product. Aside from Greece, Italy is the only country which is markedly different from the rest. By size, then, the Common Market countries could not be considered a balanced group, but in terms of economic development they show much more balance. If small countries are actually at a disadvantage when grouped with much larger countries in a customs union, we would expect the smaller economies of Belgium, Luxembourg and the Netherlands to encounter difficulties as members of the Common Market. Italy, having the less developed economy of the Six, would find itself at a disadvantage if the level of development has any relevance as a criterion in this context, as would Greece if it eventually becomes a full-fledged member.

Comparative Rates of Growth

Consideration can now be given to rates of economic growth of the Common Market members to see how well they have performed in this respect since the Common Market was inaugurated. Table 11, which gives average annual growth rates of gross national product, shows these rates of increase, not only in the aggregate for each country, but also on a per capita basis. The per capita rates reflect the ability

TABLE 11

AVERAGE ANNUAL GROWTH RATES OF GROSS NATIONAL PRODUCT AT CONSTANT PRICES[a]

(In percentages)

	Aggregate gross national product		Per capita gross national product	
	1953-58	1958-63	1953-58	1958-63
Belgium	2.5	3.9	1.9	3.3
France	4.6	5.2	3.7	3.8
Germany	6.9	5.7	5.7	4.4
Italy	5.2	6.7	4.6	6.1
Luxembourg	3.0	..	2.4	..
Netherlands	4.1	4.8	2.8	3.4
Community	5.4	5.5	4.4	4.4
Greece	6.2	6.2[b]	5.2	5.3[b]

[a]Statistical Office of the European Communities, Basic Statistics of the Community (5th ed., Brussels, 1964), p. 35.

[b]1958-62.

of the country to raise average living standards among its residents. The table also contains entries for the Community average and for Greece. The effect of inflation has been removed; the figures reflect real growth rates.

In this comparison the small countries, except Greece, recorded somewhat lower growth rates than the Community average. But of equal, if not greater, significance was the fact that both Belgium and Netherlands raised their average rates of growth during the Common Market years from 1958 to 1963 from relatively low levels in the preceding six-year period. Italy, which had the highest growth rate of all, raised its average by a full one and one-half percentage points over the preceding six years. The French rate was practically stationary, and Germany's rate of growth declined between the two six-year periods.

Imports and Exports

A common market necessarily affects the trade flows of its members. New competitive forces begin to take shape as a common market is increasingly implemented. To find out how the trade of individual members of the European Common Market has been affected in the initial years of the organization's existence, we can compare the index figures for imports and exports of these years. Table 12 shows the increases in intracommunity imports and exports for the member nations and Greece. Italy recorded a considerably higher rate of increased participation in intracommunity trade than the other members. Until 1963 Italy's trade with her partners was in reasonable balance most of the time, but in that year imports from her partners increased much faster than

TABLE 12

INDICES OF INTRACOMMUNITY EXPORTS AND IMPORTS[a]

(1958 = 100)

	Exports					
	1958	1959	1960	1961	1962	1963
Belgium-Luxembourg	100	111	139	152	179	214
France	100	134	180	213	239	272
Germany	100	113	140	167	188	227
Italy	100	132	177	215	267	295
Netherlands	100	119	138	153	169	198
Community	100	119	149	173	198	232
Greece	100	83	68	69	91	97
	Imports					
Belgium-Luxembourg	100	111	130	146	160	183
France	100	111	151	171	206	255
Germany	100	130	159	181	211	229
Italy	100	131	191	224	275	360
Netherlands	100	115	137	166	177	203
Community	100	119	149	173	198	231
Greece	100	89	98	113	126	133

[a]Statistical Office of the European Communities, Basic Statistics of the Communities (5th ed.; Brussels, 1964), pp. 108-9, 112-13.

exports to them. Here again is evidence of the effect of cost inflation in Italy on the Italian balance vis-a-vis the rest of the Community. A continuation of this trend could have somewhat serious implications for the Community's internal balance. Although the table does not give data for 1964, there is reason to believe that the imbalance between Italy's intracommunity imports and exports was redressed in 1964, or at least partially so. This is probably true because the Italian balance of payments was in surplus in 1964, as we saw in Chapter IV.

Among the other members, Table 12 shows that through 1963 Belgium-Luxembourg and France experienced more rapid growth of intracommunity exports than imports, while the reverse was true of the Netherlands, although in the latter's case the difference was not great. For Germany the growth in both exports and imports was almost the same. From the data given here for Greece we would have to conclude that Greece is not selling as much to the Common Market as it should in view of the rise of its imports from the Community.

Terms of Trade

The changing impact of a country's international transactions on its trading position may also be reflected in its terms of trade. There are limitations on the conclusions which may be drawn from comparisons of terms of trade if these comparisons are made between two points widely separated in time. This is because the terms of trade cannot take account of changes in product quality or in the products themselves. Nevertheless, comparisons over relatively short periods may provide helpful insights because neither the products that are traded nor their quality will change greatly in the short term. If the time span is brief enough, therefore, the terms of trade can be used along with balance of payments to interpret changes which may have occurred in a nation's trade picture; that is, to decide whether such changes in a nation's overall trade position are to be construed as favorable or not, and in either case, whether they may be only partially so.

As an example, suppose that a country has had a surplus in its current account for several years running and that as a likely coincident condition it has had full employment. Assume further that the current account surplus has caused an overall balance of payments surplus of equal size.[1] As a result the country would accumulate exchange reserves in the amount of the cumulation of surpluses. In itself, this may appear to be an unqualified favorable development, but if there has been a simultaneous deterioration in the

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[1]In other words, the impact of autonomous transactions in the other accounts is assumed to be neutral, so that attention may be concentrated on the current account where the effect of changing terms of trade would be felt.

nation's commodity terms of trade,[1] the development is only partially favorable. For in that case its accumulation of reserves is being made possible by a rising proportional input of its own resources; i.e., it is exporting more for each unit of imports than before.

Another type of situation may arise in which there is a deficit in a nation's balance of payments at the same time that its terms of trade have appeared to be improving. In this instance, the improvement in terms of trade is not favorable although it may appear to be. A reasonable inference would be that internal inflation had pushed the nation's export prices upward too rapidly, causing an "improvement" in the terms of trade but also bringing on a deficit in the balance of payments.

But even this type of situation would be preferable to the one in which there was a coincidence of a balance of payments deficit and deteriorating terms of trade. In the latter situation both developments could be due to fundamental structural problems which might prove to be very intractable in resolving, whereas in the former case, if both the payments deficit and "improving" commodity terms of trade

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[1]Index of export prices divided by the index of import prices.

were due to internal inflation and there was no other element in the picture, the cause of the difficulty presumably would be more easily remedied.

We have said that the commodity terms of trade for a country are found by dividing the index of its export prices by the index of its import prices.[1] It is ordinarily possible with available statistics to compute another type; namely, the income terms of trade. This is found by multiplying a nation's volume index of exports by its export price (or average value) index and dividing by its import price (or average value) index. In symbols we would write the commodity terms of trade $\frac{Pe}{Pi}$ and the income terms of trade $\frac{Qe\ Pe}{Pi}$. Presently we will show both of these for the Common Market countries for different years.

A third type of terms of trade, sometimes called the factoral terms of trade, has been discussed in the literature, but little has yet been done with it empirically because to do so requires the availability of an index of productivity for the country whose terms of trade are being calculated. Conceptual and statistical difficulties, however, have thus far made it very difficult to compute relatively

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[1]This is also sometimes referred to as the net barter terms of trade.

reliable productivity indices for a country to be used for this purpose.[1] Productivity indices are not available for all members of the Common Market. Consequently, the factoral terms of trade will not be considered.

In determining and comparing the commodity and income terms of trade, our interest is centered on whether there was a deterioration in either of these for any of the members as the Common Market was increasingly implemented. We also want to determine whether one or more countries experienced a distinct improvement in terms of trade, a rate of improvement not experienced by the rest.

Table 13 shows that from 1957 to 1963 both Germany and Italy experienced marked improvement in the commodity terms of trade, Germany's rising with little interruption from 100 to 120 and Italy's more irregularly from 90 to 102 (1953 = 100). Both France and the Netherlands also enjoyed some improvement, and only Belgium's commodity terms of trade deteriorated slightly. Greece' commodity terms of trade first rose, then fell, and between 1962 and 1963 underwent a sharp increase from 115 to 131.

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[1]See Gottfried Haberler, <u>A Survey of International Trade Theory</u> (Princeton, N. J.: International Finance Section, Princeton University Press, 1961), p. 25.

TABLE 13

COMMODITY TERMS OF TRADE[a]

(1953 = 100)

	Average Value		Terms of Trade
	Exports	Imports	
Belgium			
1957	106	102	104
1958	99	95	104
1959	95	93	102
1960	97	93	104
1961	96	95	101
1962	95	93	102
1963	95	93	102
France			
1957	106	111	95
1958	116	117	99
1959	126	128	98
1960	132	133	99
1961	131	130	101
1962	132	129	102
1963	133	131	102
Germany			
1957	103	103	100
1958	103	94	110
1959	102	91	112
1960	104	93	112
1961	104	89	117
1962	105	87	120
1963	104	87	120
Italy			
1957	95	106	90
1958	91	93	97
1959	83	87	96
1960	87	85	102
1961	84	83	101
1962	83	83	100
1963	86	85	102

TABLE 13--Continued

	Average Value		Terms of Trade
	Exports	Imports	
Netherlands			
1957	105	107	98
1958	101	101	100
1959	101	98	103
1960	100	98	102
1961	99	97	102
1962	98	96	102
1963	100	98	102
Greece			
1957	140	127	110
1958	137	116	118
1959	125	115	108
1960	122	112	109
1961	123	110	111
1962	125	109	115
1963	143	109	131

[a]Organization for Economic Cooperation and Development, General Statistics, September, 1964.

Let us next consider the income terms of trade. It was suggested by the Economic Commission for Latin America in their *Economic Survey of Latin America*, 1949, that this measure be regarded as an index of the "capacity to import" because it shows the quantity of imports bought by exports. The import price index in this measure serves as a deflator of the value of exports obtained by multiplying the export quantity index by the export price or average value index.

Table 14 shows that Italy's capacity to import more than doubled from 1957 to 1963, while Germany's increased a little less dramatically during the same period. The percentage growth in the capacity to import for each country was as follows: Italy, 148; Germany, 94; France, 83; Netherlands, 74; Belgium, 62; and Greece, 54.

TABLE 14

INCOME TERMS OF TRADE[a]

(1953 = 100)

	Commodity Terms of Trade	Export Quantity Index	Income Terms of Trade
Belgium			
1957	104	133	138
1958	104	136	141
1959	102	154	157
1960	104	168	175
1961	101	177	179
1962	102	197	201
1963	102	219	223
France			
1957	95	131	124
1958	99	137	136
1959	98	164	161
1960	99	192	190
1961	101	202	204
1962	102	205	209
1963	102	223	227
Germany			
1957	100	188	188
1958	110	194	213
1959	112	217	243
1960	112	249	279
1961	117	264	309
1962	120	273	328
1963	120	303	364

TABLE 14--Continued

	Commodity Terms of Trade	Export Quantity Index	Income Terms of Trade
Italy			
1957	90	178	160
1958	97	189	183
1959	96	232	223
1960	102	280	286
1961	101	336	339
1962	100	377	377
1963	102	389	397
Netherlands			
1957	98	135	132
1958	100	147	147
1959	103	165	170
1960	102	188	192
1961	102	193	197
1962	102	207	211
1963	102	225	230
Greece			
1957	110	139	153
1958	118	150	177
1959	108	145	157
1960	109	147	160
1961	111	161	179
1962	115	175	201
1963	131	179	235

[a]Organization for Economic Cooperation and Development, General Statistics, September, 1964.

There is a more than casual correspondence between these percentages of growth in the capacity to import of the several countries and the increases in per capita gross national product indicated in Table 11. That is, the order in which the Common Market members stood in regard to their growth in capacity to import was exactly the same as their ranking with respect to individual increases in average annual per capita real gross national product from 1957 to 1963. Only Greece' showing with respect to growth in capacity to import differed markedly from her performance in increasing per capita gross national product from 1957 to 1963. But Greece did not become associated until 1962.

The success of the two economies which led in increasing national output (Italy and Germany) was very probably related to their ability to participate to a greater degree in the growth of international trade as evidenced by the more rapid rise in the export quantity index for both these nations. This, in turn, made possible the more rapid increase in the capacity to import.

Italy's income terms of trade or capacity to import improved more than Germany's, due entirely to a greater increase in the quantity export index.

The diverse trends here evident with respect to the terms of trade very possibly had nothing to do with any influence of the Common Market. If they are assumed to have been caused by effects of the changes introduced by the Common Market, this could be interpreted to mean that smaller economies can expect a worsening of their terms of trade as partners of larger economies. However, it should be remembered that as a member of a common market, a smaller economy cannot be damaged by an act of one of its partners in arbitrarily raising barriers against its exports. Also, trade blocs are supposed to have more bargaining power than their member economies individually. Therefore, a smaller economy would have some protection for its terms of trade as a member of a common market.

Terms of trade, we know, are not wholly unaffected by the relative inflationary and anti-inflationary policies of the respective governments. A government which opts for a relatively more inflationary policy can bring about an improvement in the country's commodity terms of trade but may thereby cause a smaller relative improvement in the income terms of trade and throw its balance of payments into deficit. Thus, the Italian commodity terms of trade improved from 100 to 102 between 1962 and 1963, and the Italian income terms of trade improved from 377 to 397. But the latter was a relatively smaller improvement than Belgium's improvement in its income terms of trade from 201 to 223 which took place though its commodity terms of trade remained unchanged at 102. At the same time, the Italian current account fell deeply into deficit, while Belgium's current account was not far out of balance in 1963.

Summary

In this chapter we have seen that the Italian economy by several measures showed the most vigorous response to the stimulus provided by the Common Market. Its increases in aggregate GNP and average annual per capita GNP and its improvement in income terms of trade exceeded those for other member countries. This result conflicts with one of the points discussed earlier in the chapter which implied that countries with less advanced economies might find it difficult to adjust to the more and more unrestricted competition of a customs union or common market, the others members of which were more developed.

Overall, the smaller economies showed a somewhat lower level of performance than their larger partners in the Common Market from 1958 to 1963. Belgium had the smallest recorded increase in aggregate and per capita GNP, while its commodity terms of trade worsened slightly and its income terms of trade improved less than its partners'. The Dutch economy did only slightly better in these respects. On the other hand, Belgium, which had the lowest percentage increase in per capita GNP between 1953 and 1958, improved its growth rate between 1958 and 1963 over the rate between 1953 and 1958 more than any other member except Italy. And in this respect, the Netherlands showed more gain than did France and Germany. Germany's growth rate from 1958 to 1963, though relatively high, was lower than its growth rate from 1953 to 1958, but this is not to suggest that the drop was due to effects of the Common Market on Germany.

While apparently gaining less from the Common Market in some respects than France, Germany and Italy, the smaller members were able to realize sufficient benefits to increase economic welfare among their residents. Furthermore, their rates of growth in per capita real GNP were significantly higher during these years than those of three important industrially advanced economies not in the EEC, namely, the United States, Canada and the United Kingdom.[1]

Finally, by most criteria Germany benefited very much from the Common Market, albeit less than Italy.

In the next chapter we shift our attention to factor movements and search for any effects of the Common Market on them.

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[1]In percentages, U. S., 2.5; Canada, 1.7; and U. K., 2.6.

CHAPTER VI

FACTOR MOVEMENTS

Our purpose in studying movements of labor and capital between the members of the Common Market is to ascertain whether there has been a tendency for one or more members to gain either of these resources to the increasing detriment of one or more other members. A common market involves a customs union as its basic feature but goes beyond a simple customs union in providing for unrestricted movement of labor and capital between the separate political units making up the common market. Theoretically, as an area which formerly was partitioned for trade purposes is opened for freer movement of mobile resources, a certain amount of movement in these resources will take place in response to differential rates of return in the different parts of the area. Ideally, some capital would migrate from regions where it was in relatively abundant supply to regions where it was relatively scarce, and similarly for labor. Less capitalized regions thus would be benefited while regions with surplus labor would be helped in the solution of their unemployment problems. In some situations, however, this desirable development predicted by traditional abstract theory may not happen as indicated. Some analysts of common market problems believe that a type of perverse development may occur in which both capital and labor would move in the same direction. Some regions may gain capital <u>and</u> labor at the expense of other regions, or alternatively, some regions may lose skilled and energetic elements of their labor force without being compensated by any significant inflow of capital. At the same time, the more favored regions may gain these desirable labor resources but export little or no capital to less favored regions. Location theory is used to analyze some of the possibilities.

Regional Agglomeration

When Western European economic integration was still in the discussion stage, one group of theorists foresaw its realization as causing a shift in the location of industry such that there would be increasing concentration in favored areas. Employing the terminology of location theory, there would be a tendency toward regional and away from national agglomeration.[1] These theorists expected that Western European integration would strengthen the attractiveness of the highly industrialized center, for both labor and capital. Towns and regions with artificial advantages due strictly to national agglomeration when production and trade was more nationally oriented would lose some of their advantages. Both capital and labor might gravitate away from poorer regions and countries to richer. "It could happen, for instance, that in the absence of a sufficient number of 'ubiquitous' branches, a country poorly endowed with natural resources may find that union means, for it, the massive emigration of its labor force and capital. Contrary to the conclusions based on the assumptions of classical theory, it would then be the 'rich' country which would be the beneficiary of union. The 'poor' country would be reduced to production of small capital intensity, for instance to agriculture."[2] Or in the words of Professor Brown, an associa-

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[1]An agglomeration may be defined as an increasing geographical concentration of economic activity in response to a production or marketing advantage resulting from the carrying on of production to a considerable extent in one place. See Balassa, op. cit., p. 194.

[2]Maurice Bye, "Customs Unions and National Interests", International Economic Papers, No. 3 (1953), p. 226. See also Herbert Giersch, "Economic Union between Nations and the Location of Industries", Review of Economic Studies, No. 2 (1949-50), pp. 91-92.

tion in which formerly protected poorer regions enter a union with developed richer regions poses the possibility that the poorer regions will be "sucked dry."[1]

These views on the effect of regional economic integration on less developed economies can be compared with those of Gunnar Myrdal regarding the damaging effect of freer trade on underdeveloped countries. Myrdal believes that free trade results in an increase in international inequalities.[2] Freer trade between developed and underdeveloped countries, according to Myrdal, tends to freeze specialization in established patterns, so that the underdeveloped economies remain largely producers of primary products for which world demand is both unstable and inelastic. Moreover, he says, terms of trade have tended to worsen for the poorer nations further hindering their efforts to increase national income. In general, he calls for larger doses of aid, internationally administered, from the rich nations, and for unilateral removal of their trade barriers against the poorer nations' exports. His view of the Common Market in 1960 seemed to be

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[1]A. J. Brown, "Common Market Criteria and Experience," Three Banks Review, No. 57, (1963), p. 6.

[2]See Rich Lands and Poor, (New York: Harper and Bros., 1957), ch. 5; also, Beyond the Welfare State (New Haven: Yale University Press, 1960), pp. 241-244.

that it had the earmarks of a club organized for the selfish advancement of its members' interests at the expense of curtailing their economic relations with nations outside it.[1]

The location of greatest industrial concentration in Western Europe is the Ruhr in Germany and the adjacent regions of neighboring countries. It was believed by those writers who maintain that regional economic integration tends to accentuate regional disparities that the region around the Ruhr would gain the most from the Common Market. Its gains, it was thought, would be at the expense of the south and west of France and most of Italy.[2] The principal beneficiaries of the plan, in addition to Germany, would be the Benelux countries.

In placing emphasis on the increase in regional disparities growing out of economic integration, the represen-

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[1]Beyond the Welfare State, pp. 147-48. Myrdal might have been premature in his criticism. Hallstein recently noted that "our imports from all developing countries have been roughly ten times as high as those of the Soviet Union, twice as high as those of the United Kingdom and far above those of the United States. Effective financial aid by the Six in 1962 amounted to 2,800 million dollars as against an estimated 390 million dollars from the entire Eastern bloc. Nor did the greater part of this aid go to Africa, although economic, geographical and historical links give Europe an outstanding role in the development of this continent . . ." Community Topics 17 (European Community Information Service, 1965), p. 13.

[2]See Balassa, op. cit., p. 203.

tatives of this school of thought overlooked or discounted opposite developmental tendencies which may accompany the institutional changes. Location theory demonstrates that in situations where agglomerative factors have been at work, a point can be reached where deglomerative factors, which have their origin in uneconomic increases in both land rents and labor costs, can begin to appear.[1] In addition, when national barriers to trade are removed, regions near frontiers formerly at a disadvantage because of unnatural barriers to commodity and factor movements may now develop under the influence of liberalized commerce. These newly favored regions presumably may be a part of smaller and less developed as well as of larger developed countries. A third possibility would be that "spread effects" from highly developed regions would reach out to benefit backward regions of a union. These effects may occur in the form of rising demand for the less developed regions' products, an increase of mobile external economies and resettlement of plants to take advantage of wage differences.[2] A survey of these possibilities indicates that conflicting economic forces affecting

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[1] *Ibid.*, p. 194.

[2] *Ibid.*, p. 204.

the location of industry may well begin to exert themselves after a common market begins to operate.

Capital Movements

What has actually happened in the Common Market during its initial years with respect to movements of capital and labor among the Six? Insofar as capital is concerned, Table 15 shows us there has been no massive movement into or out of any of the member countries. Within the Community, the Benelux countries, especially Holland, have been net exporters of direct investment and private long-term capital. The other members appear to have been importers of long-term capital within the EEC, but not in amounts which can be considered large for a four or five-year period. It is possibly of some significance that Germany, which within the context of the Community was already well endowed with capital, was a net importer of private capital, apparently for the most part from the Benelux countries. All members except Belgium-Luxembourg experienced inflows of private capital from the United States and Canada, the Netherlands' inflow of $514 million being the largest.

Capital amounting to $172 million was invested in Italy, the least advanced economy in the Community, from other Common Market members between 1959 and 1963. Of this

TABLE 15

CAPITAL MOVEMENTS AMONG EEC COUNTRIES AND THE UNITED STATES AND CANADA

(In millions of dollars)

	With U.S. & Canada	With EEC Countries
Belgium-Luxembourg[b]		
Direct investment and other private long-term	-40	-146
Government		16
		-130
France[c]		
Direct investment[d]	150	94
Other private long-term	288	76
Government		16
	438	186
Germany[e]		
Direct investment and other private long-term	251	59
Government		51
		110
Italy[f]		
Direct investment and other private long-term	451	101
Government		71
		172
Netherlands[g]		
Direct investment and other private long-term	514	-479
Government		-8
		-487[h]

[a]Compiled from IMF, Balance of Payments Yearbooks 12, 13, 14, 15 and 16.

[b]For years 1960-63; [c]For years 1960-62.

[d]Includes some investment in associated enterprises.

[e]For years 1959-62. [f]For years 1959-63. Private and government investment under EEC Countries column includes investment vis-a-vis all non-sterling OEEC countries in 1960.

[g]For years 1959-63. [h]Including the European Fund and EEC institutions.

amount approximately $100 million was direct investment and other private long term, while $71 million was government capital. These sums do not reflect further investment which is destined for Italy as a result of its membership in the Common Market. The European Investment Bank, an official Community institution, has committed the greater part of its loan capital to Italy. Of $358.3 million in loans approved up to the end of 1963, $236.1 million, or 66 per cent, was earmarked for Italy.[1] Much of this money going to Italy is being concentrated in the south, a region known as the Mezzogiorno, which for decades has been economically stagnant. The loans from the European Investment Bank have been supplemented by loans from other foreign sources. As a result of this investment and other special efforts by the Italian government, "unemployment now affects only 3 per cent of the active population in the south of Italy."[2] Chronic under-

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[1]European Investment Bank, Annual Report (1963), p. 59.

[2]Ibid., p. 47. The Annual Report further states that "During the period 1950-62, total investment in the Mezzogiorno increased at the average rate of 11 per cent per year at constant prices, a rate higher than that for Italy as a whole (9 per cent) and that of the Community (8 per cent). This increase concerns both agriculture and industry, investment by individuals and that of private and public enterprises, as well as the action of the State through the public authorities and the Casa per il Mezzogiorno." --pp. 47-48.

employment in agriculture has dropped, and there has been a steady flow of labor out of poor agricultural employment into industries, both in the region and elsewhere.

Labor Migrations

The situation with respect to labor movements is less complicated. The dominant development has been the moderately large migration of Italian labor to other members of the Community, principally France and Germany. Table 16 shows the net migration of labor between Italy and the other members of the Community for each of several years.

TABLE 16

NET MIGRATION OF ITALIAN WORKERS, 1958-63[a]
(In thousands)

	1958	1959	1960	1961	1962	1963
Belgium	2.1	-3.6	-4.3	-2.9	1.0	..
France	29.6	15.4	24.2	20.3	26.0	12.9[b]
Germany	12.6	21.7	86.0	86.6	70.1	20.9
Luxembourg	2.1	1.2	1.5	2.1	2.2	.0
Netherlands	-1.1	-0.6	0.9	2.6	0.5	-0.4
Total	45.3	34.1	108.3	108.7	99.8	34.2

[a]Compiled from Statistical Office of the European Communities, *Statistics of Employment in the Countries of the Community and Greece*, No. 4, 1963, and *Statistics of Employment in the Countries of the Community*, Supplement 1964.

[b]To June 30.

Positive entries signify increases in the number of Italian workers in each country. The table indicates that the flow of Italian workers into the other member countries began to taper off in 1962. Table 17 gives the net movement of workers into and out of each country vis-a-vis the rest of the EEC and the world. Positive entries signify a net immigration. Table 18 gives unemployment percentages for EEC members from 1958 to 1963.

TABLE 17

NET MIGRATIONS BETWEEN COUNTRIES OF THE EEC AND THE WORLD, 1958-62[a]

	EEC	World
Belgium	1,062	34,216
France	87,418	..
Germany	339,230	1,619,311
Italy	-396,241	-778,293
Luxembourg	12,153	12,564
Netherlands	-3,286	5,751

[a]Compiled from Statistical Office of the European Communities, Statistics of Employment in the Countries of the Community and Greece, No. 4, 1963.

An Evaluation

Is it possible to evaluate the effect of the operation of the Common Market on its members as far as it may be revealed in these statistics on capital and labor movements? The four basic tables to which we have referred are certainly not sufficient for a detailed and exhaustive appraisal of these movements. They present the data only in

TABLE 18

UNEMPLOYMENT IN THE EEC[a]

	1958	1959	1960	1961	1962	1963
	Per Cent of Labor Force					
Belgium	5.2	6.0	5.2	4.2	2.2	2.4
France	0.9	1.3	1.2	1.1	1.2	1.4
Germany	2.7	1.9	0.9	0.6	0.5	0.6
Italy	6.4	5.4	4.0	3.4	2.9	2.5
Netherlands	2.3	1.8	1.1	0.8	0.7	0.9

[a]Compiled from Manpower Statistics 1950-1962, Organization for Economic Cooperation and Development, Paris, and General Statistics, OECD, (September 1964).

broad aggregates. A lengthy, detailed study is beyond the scope of this paper and moreover is probably not necessary for our purposes. The aggregates appear to present enough information to substantiate several conclusions.

1. The outstanding feature to be noted is the absorption of the large number of Italian and other foreign workers by the German economy. Despite this absorption, the economy at times has experienced labor shortages when many requirements have not been filled. Without so large an assist from supplies of foreign labor the economy's growth rate would have been slowed. While the other members, especially France and excepting Italy, also had a net inflow

of labor, Germany's was by far the largest. The impression is made that Germany's economy possesses considerable dynamism and definite expansive characteristics.

2. The exodus of workers from Italy is about what we would expect to happen when the reserves of a labor surplus region are free to migrate in response to labor market inducements. For the present it has been advantageous both to Italy and the other members which have imported Italian labor. Italy has been relieved of dealing with what might have been a serious unemployment problem. In addition, some of the earnings of Italian nationals have been remitted to Italy and have been the source of substantial credits in the Italian balance of payments.

Migration of surplus labor can be an advantage to the exporting country so long as the labor resources involved are not the "cream" of the labor force and so long as it does not hamper the internal development of that country's economy. As we saw in Chapter IV, a point was finally reached when Italian labor reserves approached depletion with consequent excessive pressure on wage rates and export prices and a deterioration in the Italian external balance.

3. It is doubtful that in the first five or six years of the Common Market's operation that any member's

economy was damaged by excessive losses of capital to its partners. There was an outflow of private capital of moderate proportions from the Benelux countries to other members, but the labor unemployment rate fell to low levels in these countries as it did in the rest of the Community, and output expanded at rates, which though lower than the average for the Community, would not be considered unsatisfactory.

CHAPTER VII

SUMMARY AND CONCLUSIONS

The European Common Market in 1958 has come to be referred to as "the Common Market" in much contemporary discussion. The general public probably thinks of it as the only such institution which has ever been in existence. But it is only one of a number of comparable organizations which have existed before and exist today.

Common markets are regional organizations designed to surmount obstacles to international trade when freer trade is impossible to achieve on a multilateral basis. The German Zollverein is an earlier example of a common market, one of the few attempts at economic integration which bore fruit long enough to set the stage for the founding of a new nation. Valid comparisons can be made between the Zollverein and the European Common Market. It is possible, but as yet by no means certain, that the Common Market will result in the formation of some type of new European political federation, in effect converting six sovereign states into a single nation.

There are, however, certain dissimilarities between the Zollverein of nineteenth-century Germany and the European Common Market. These dissimilarities were pointed out in Chapter II where the history of the Zollverein was recounted. The differences are believed by the writer to be significant enough to throw into doubt the view that Prussia's role in the Zollverein is at all comparable to West Germany's position in the Common Market.

In Chapter III the events and negotiations leading up to the Treaty of Rome were reviewed. In the writer's opinion they provided a sound basis for concluding that the Common Market was formed as a result of a broad consensus among Europeans and their leaders that such an organization would serve a vital purpose. No compelling reason could be found for believing that German political or business leaders had an exceptional role in influencing the outcome.

Balance of payments histories were the subject of Chapter IV. An analysis was made of these histories to determine whether any member(s) had had extended and troublesome deficits which might indicate difficulties created by competitive pressures from a potentially dominant member of the union such as Germany. Since every member had had aggregate surpluses for the years 1958 to 1964, it was concluded that on this score evidence was lacking that any of the national economies had been damaged by the intensification of competition from a dominant partner. The large Italian deficit of 1963 was explained by internal inflation in combination with other factors quite indirectly related to competition within the Common Market.

In Chapter V data were introduced to show the changes and trends in the national economies of the Common Market in respect to their national products and foreign trade. Again we were looking for imbalances and other signs of instability caused by possible domination of the union by one member. Here we found some variation in growth rates. The smaller economies had demonstrably lower rates than their larger partners. But any interpretation which might have been placed on this, linking it to the Common Market, was obscured by the fact that the smaller economies and also Italy had improved their per capita growth rates in the years that they had been members of the Common Market, whereas Germany and France had not. Italy, the least developed country of the Six, had the highest growth rate in the Community. The German growth rate was second highest to that of Italy. Germany and Italy also scored high in the improvement of their terms of trade.

Factor movements were the subject of Chapter VI. These are considered important for the analysis of Common Market problems because as the Common Market has been implemented, more liberty has been granted to labor and owners of capital for the transfer of these resources across national boundaries in the Community in response to market inducements. We know from history and experience that labor surpluses tend to migrate when given the opportunity. This has happened in the Community where several hundred thousand Italians have found employment in the economies of the other member countries. Germany, over a period of time, has absorbed the largest number of Italian workers in addition to many thousand workers from southern Europe, making the total influx of foreign workers in Germany well over a million and a half. Other than the migration of Italian workers, labor movements among members of the Community have not been large enough to be significant in the context of this study.

Whereas Italy has exported large supplies of labor to other members of the Common Market, it has imported a moderate amount of investment capital from them. Belgium and the Netherlands appear to have been the only net exporters of capital within the Community through 1963.

Conclusion

We set out to ascertain whether Germany had as yet begun to dominate the Common Market to the extent of hurting the economies of any of the other members of the Community by its alleged economic advantages and competitive strength. No convincing evidence was found to support the hypothesis in this form.

The economy of every member state has operated at high levels of activity, there have been surpluses in the balances of payments and fairly steady advances in output and volume of trade. Other reasons advanced for this conclusion are (1) Italy, the least developed among Common Market members, attained a rate of growth, both in output and trade within the Community, greater than Germany's; (2) intracommunity exports of no member diminished during the six-year period but, on the contrary, expanded at a rate which for some countries exceeded the German rate of increase.

The conclusion here reached should not be interpreted as categorically indicating that the German economy enjoyed no greater benefits by Common Market membership than any of the other participants. Germany has maintained an economic growth rate which has been higher than that of any other member except Italy. It has had less inflation than France or Italy. Its commodity terms of trade showed the greatest improvement. Can we then conclude all this was due to Common Market membership? This is a possible, even a plausible, explanation. But we cannot be sure that similar or perhaps larger gains might not have been achieved by Germany had there been no European Common Market. The German economy may indeed be more dynamic than the other national economies which make up the Community, but it has not been shown up to now that the others have been damaged by their being in the same trade bloc with it.

It must be admitted that the conditions under which the Common Market has developed have been highly favorable. For the most part, the years since its founding have included a more or less continuous economic expansion unmarred by a serious recession in Europe. In the future, if a recession does develop, some of the fears of those who have regarded the Community as fundamentally unbalanced and dominated by Germany may prove correct. In that case, unemployment and underutilization of resources may rise more steeply in some regions outside Germany than within. But there is no overwhelming reason to think that this tendency should become aggravated in the absence of discriminatory measures and subsidization of exports, both of which, of course, will be prohibited under the Common Market. Even a mild tendency for this to happen, i.e., for other regions in the Community than Germany to experience higher recessionary unemployment, is by no means foreordained. But conceding for the sake of argument that this may happen, the increase in trade barriers which depressions sometimes have led nations to institute are hardly a desirable alternative. It seems reasonable to believe that general recovery from depression would be easier and more quickly attained if trade remained relatively free within a customs area than would be true if it were increasingly restricted through national efforts to export unemployment.

Finally, the implications of our findings in the case of the Common Market look favorable for common markets in general. They indicate that possible difficulties created by differences in size and level of development between members of a common market are not necessarily insurmountable or prohibitive of the success of the union. Every projected common market, of course, has its own unique conditions, and initial disparities in regional incomes greater than those found in the European Common Market may bar the success of other common markets where this condition exists.

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