Problems of European Economic Integration (*)

The affairs of Europe are characterized by a labyrinthic intricacy. The difficulties start right away with the definition of Europe itself. I draw from my sources that the name of Europe came to be applied to the land west of the Ural mountains and the Caspian sea because, through affinity of physical features and climate, this land was occupied by countries in intimate relations with one another; not always of a peaceful nature one might add, and separated from the countries of Asia by unpeopled or very sparsely peopled areas. And, the source continues, within the limits thus marked out on the East, the inhabitants of Europe developed a civilization of essentially the same type and a common history.

The eastern frontier of Europe was not coterminous with a national boundary. It ran entirely within one state — Russia. Following the Communist revolution of 1917, increased political and economic significance came to be attached to the line dividing the Soviet Union as a whole from the rest of the world. The line of the Urals vanished accordingly into oblivion. But we continued to speak of Europe, in a somewhat narrower sense, treating the Soviet Union as a totally separate entity.

After World War II, a new and painful adjustment in the use of terms became necessary. Several European countries fell under Communist rule, and the Iron curtain became for most purposes the relevant line of division between East and West. The line departs sometimes from geographic realities. In its Southern stretches, it bends eastwards to embrace Greece and Turkey into Western Europe. Tito's Yugoslavia is seated astride the fence.

All the countries in this politically defined Western Europe are members of the Organisation for European Economic Cooperation, O.E.E.C., with the exception of Finland.

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Political and economic divisions unfortunately exist within Western Europe itself.

Politically, Western Europe is divided between N.A.T.O. countries and neutrals. This distinction is of some economic consequence, as we shall see later on.

But the division which will chiefly occupy us in this lecture is that between the Six and the remaining Western European Countries. From the two sides of the Common Market fence, conflicting voices are raised. Those inside the Common Market think that Western Europe is integrating; those outside it that it is *disintegrating*.

In the early post-war years, several suggestions were made and negotiations started having in view the formation of Customs Unions between two or more Western European countries. They all miscarried, except in the case of Benelux, a customs union of three countries (Belgium, the Netherlands and Luxembourg) which had been conceived during the war by their Governments in exile.

In December 1947, a multilateral payments agreement was concluded among six countries, aiming at the clearing of claims arising from their trade relations. The parties to this agreement were Western Germany (then under military occupation), France, Italy and the three Benelux countries. This was the first transient appearance of the Six. But the agreement was eventually superseded by the European Payments Union, embracing all O.E.E.C. countries.

The Six really acquired their capital S in 1951, by establishing the European Coal and Steel Community.

The creation of conditions that would avoid the recurrence of war between France and Germany was viewed in both countries as a primary policy objective, and the establishment of some permanent community of interest between the basic industries of the two countries was an approach to the problem — and a specially valid one in the case of the *steel* industry. In an official declaration of 1950, it was stressed that the pooling of coal and steel production would change the destinies of those regions which had long been devoted to the manufacture of munitions of war, of which they had constantly been victims.

The intellectual leadership in forging the new bond between France and Germany was mainly provided by the French. The names of M. Monnet and M. Schuman come to the mind. The Benelux countries and Italy joined in during the negotiations, and the Community, which had been conceived at first as a Franco-German pact, became a six country venture.

And the venture was on the whole a success. Coal, iron ore, scrap and steel are now traded freely within the Community, while for imports from the rest of the world the six countries apply a harmonized tariff.

The Six continued to cooperate with the rest of Western Europe in their individual capacity as members of O.E.E.C. Under the auspices of this body, trade inside Western Europe was largely freed from import quotas. The process started in 1949; by the end of 1956, about 90 per cent of the trade among O.E.E.C. countries had been *liberated*, in the technical sense that quantitative restrictions on imports had been removed, though of course import duties continued to be levied.

A stage had therefore been reached at which further progress towards free trade implied an attack on the hard core of residual import quotas and on import duties themselves. O.E.E.C. proved incapable of this further advance.

The decisions of its Council are adopted by unanimity rule. Those members of O.E.E.C. that had lower tariffs, namely the Benelux and the Scandinavian countries, when asked to remove their remaining import quotas, claimed some corresponding reduction of import duties on the part of the members having higher tariffs, among them Great Britain, France and Italy.

But there was an obstacle to this deal. All O.E.E.C. countries, with the exception of Switzerland, are parties to G.A.T.T., the General Agreement on Tariffs and Trade. The Agreement allows two or more member countries to remove all tariffs among themselves, but it prevents them from stopping short of that — more precisely, it prevents them from picking out certain duties for suppression, while others would be simply lowered or would be retained. In economic parlance, two or more countries may, under the Agreement, establish among themselves a full-fledged customs union, or a free trade area, but they may not set up a Preferential Area.

While forbidding the formation of new preferential areas, the Agreement recognizes the legitimacy of preexisting arrangements, provided that the degree of preference is not increased. The Ottawa agreements among countries of the British Commonwealth are by far the most important instance of a preferential area.

Under G.A.T.T. rules, therefore, an attack on import duties inside O.E.E.C. implied a readiness of its member countries to go the whole length required to form a customs union or a free trade area. This readiness was not extant, and O.E.E.C. had to fall back on the pursuit of less ambitious courses. It followed up on the liberation of commodity trade with the removal of exchange restrictions applying to other current transactions — such as payments for travel, freights, insurance, interest and so on. It encouraged the liberation of dollar imports, which has made great progress during the past year. It made a cautious approach to the liberation of capital movements, mainly in view of promoting direct productive investment, such as the setting up of factories abroad.

This limitation of the objectives pursued by O.E.E.C. left to the Six the initiative of a real dash towards economic unity. Their foreign ministers met in Messina in June 1955, and decided that the time had come for a " relaunching of Europe " and the establishment of a Common Market. A Committee, under the leadership of the Belgian foreign minister, M. Spaak, was required to translate this resolution into specific proposals for a Treaty. The Committee worked with great alacrity in Brussels. British representatives took part in the early stages of Committee work, then withdrew. By April 1956 the Spaak report was ready, and in March 1957 the Six signed in Rome two Treaties, establishing a European Community for Atomic Energy, or Euratom, and a European Economic Community.

So, proceeding twice by division and once by integration, we have got here this Little Europe of the Six — an area equal to barely one third of the total O.E.E.C. area and to about one eighth the area of Europe as historically defined. In terms of population, the Six account for about one third of the total population of Europe as historically defined.

Under the Atomic Community Treaty, the Six countries are committed to pursuing a common nuclear development policy. They are going to coordinate investment decisions, and they have set up the machinery for joint financing of investment by the Community and joint ownership of certain nuclear plants. There is pooling of research activities, common safety regulations and agreed controls over the use of nuclear materials. A single agency is in charge of the supply of nuclear fuels and fissionable materials. And of course a common external tariff is adopted for such materials. However, this last commitment, which is spelled out in the Atomic Community Treaty, is also implicit in the more general obligation to establish a unified import tariff for all goods, which derives from the second and more important Treaty — the one setting up a European Economic Community.

Under this Treaty, the six countries are committed to establishing a Common Market over a transitional period of 12 years which will be completed at the end of 1969. In the trade relations between themselves, quantitative restrictions and import duties are to be removed in stages.

The first ten per cent reduction in existing duties took place in January 1959 and the second, of equal amount, is due in July of the current year. Up to one year ago, when the economic rehabilitation of France was started, some slipping in the agreed time-table of tariff reductions seemed fairly probable. To-day, the tendency is rather to advance the time-table; the Belgian government has been advocating such a speeding up and there is perhaps a feeling that by making the Common Market a *fait accompli*, the Six will gain a strategic advantage in negotiations.

The Six, of their own free choice, extended to all G.A.T.T. countries the first tariff reduction, and there are indications that they will proceed likewise with the second. However, there is, for each import item, a floor to such reductions in favor of third countries, namely the import duty fixed in the common external tariff of the Community, which will supersede the national tariffs at the end of the transitional period. (Incidentally, the customs territories of the Community are *four* rather than *six*, because the three Benelux countries already form an economic union with a single external tariff).

The removal of import quotas in trade between the Six is also proceeding according to plan. The first quota relaxation took place at the beginning of the past year and the second on January 1st of this year. By and large, the benefit of bigger import quotas has also been extended to third countries. The trend all over Western Europe to-day is towards the abandonment of quantitative restrictions, except in the field of farm products. If this trend is maintained, quotas for non-agricultural goods will be scrapped by the Six in advance of Rome Treaty obligations in trade within the Community and will be equally removed in trade with third countries. Even France, which used to be considered as the laggard in the movement toward freer trade, has declared through M. Pinay that she intends to remove import quotas within two years.

In conclusion, during the first two years of implementation of the Rome Treaty, each country in the Community, in addition to opening up its market to the competition of the other member countries in accordance with Treaty obligations, has so far opened it voluntarily, and roughly to an equivalent extent, to competition from third countries.

This generosity would appear to spring from two sources. First, the conduct of economic policy in the Six happens to be at present largely entrusted to men who believe in the virtues of competition. Second, recent balance of payments developments have been exceedingly favorable for all members of the group. In this respect, the tendency to *overspend*, which has characterized American foreign economic policy during the fifties, has been a powerful agent in promoting freer trade and the integration process in Europe. It has floated our economies on a tide of incoming gold and dollars, and made us readier to run the risks of import liberalisation.

So far, so good. But there is another side to the Roman coin. The reduction of import duties in trade relations between the Six will be continued until the duties are brought down to nil in about ten years from now. For imports from the rest of the world, the common external tariff of the Community will then apply. As a general rule, the rates of the common tariff have been established by taking the unweighted arithmetic average of the rates applied at the beginning of 1957 in the four customs territories of the Community. The Benelux and the German tariffs are lower than those of France and Italy. Accordingly the rates of the Common Tariff are for many items *higher* than those applied at present by Benelux and Germany; so that the gradual harmonization of the Benelux and the German tariffs to the common external tariff will imply *upward* adjustments of duties. Such harmonization will take place gradually during the transitional period, and imports into Germany and Benelux from the rest of the world will suffer from it. In some instances, this will also be the case for imports into Italy and France.

The effect of the external tariff will obviously be to divert some trade from outside suppliers to suppliers inside the Community. For instance, German manufactures having free access to the markets of France, Italy and Benelux, will displace imports from such outside sources as the United Kingdom and the United States. Similarly, Dutch or Italian agricultural exports to Germany will dislodge imports from Denmark or from primary producers overseas.

In the case of the outside primary producers, the loss of trade will be made more serious by a stipulation in the Rome Treaty which has aroused acute controversy. Under the Treaty, the overseas territories having special connections with the Six (mainly French Africa and the Belgian Congo) enjoy a special status of association with the Community. They are entitled to free entry for their goods into the markets of the Six, while retaining the right to erect barriers against imports from the Six — the reasoning being that of protecting nascent industries in the colonies or former colonies. The importance of the competitive edge that free access to the markets of the Six secures for the associated territories overseas may be roughly gauged by the following instances of Common Market duties that will apply to tropical or subtropical products imported from outside countries: bananas 20%, citrus fruit from 8 to 20%, coffee 16%, sugar 80%, cocoa 9%, tobacco 30%.

We have here a case of one-way free trade, not amenable to the forms of association permissible under G.A.T.T. The consistency of this part of the Rome Treaty with the G.A.T.T. agreement was hotly debated in Geneva; but the Six were adamant in maintaining that the Rome Treaty had to be accepted or rejected *in toto*, as it stood.

A number of countries in Africa are at present acquiring independence. In so far as they remain in the French or Belgian community, they will perhaps continue to enjoy the benefit of association to the Common Market, mainly free entry for their goods, without any countervailing obligations; also availability of finance through the 581 million dollar development fund envisioned in the Rome Treaty. The Common Market arrangements may therefore become an important element of cohesion for otherwise shaky empires.

The outside world has already reacted, and will presumably continue to react in various ways to the potential diversion of trade caused by the Common Market arrangements.

The convention of association of the overseas territories has a duration of 5 years. It will presumably come again under attack in G.A.T.T. when it becomes due for renewal.

The external tariff of the Six is negotiable and the Six have repeatedly asserted that they are *outward looking* and want to promote trade on a world basis. Action for a balanced reduction of tariffs by the United States, Great Britain and the Community will presumably develop in G.A.T.T. during the 1960-61 session.

Another reaction has been a widespread movement to form economic and political unions in other parts of the world. Negotiations are proceeding, or suggestions are being put forward, in Latin America, Africa, South East Asia.

In Europe, the outsiders will continue their efforts to form a wider association of which the Six would be one component, though an embarassingly big one.

To explore this possibility, we must go back to 1956 and pick up another thread in the pattern of recent developments, namely, the story of the Free Trade Area negotiations.

As I mentioned earlier, a harmonized tariff for imports into the Six already applies, under the Coal and Steel Community Treaty, in the case of coal and steel products, and a common tariff will apply to all other goods at the end of 1969. Under these conditions, a reasonable degree of administrative cooperation between the customs authorities will as a rule be sufficient to ensure that the goods are cleared through the customs of the country to which they are ultimately directed.

In a free trade area, each country retains its own tariff, which is applied to imports from non-members. And here lies the snag. For exporters from non-member countries will have an inducement to enter the free trade area where the tariff fence is lowest, and to move on the goods to all parts of the area, except of course when the extra cost of the detour would be higher than the duty differential. To prevent commodity shunting, free trade areas use certificates of origin. Goods that originate within the area enjoy area status and move freely between member countries. Goods imported from non-member countries do not qualify for area status. They pay duty in the country of ultimate destination under that country's individual tariff. Difficult problems arise in the case of products manufactured within the area using raw materials or semi-processed goods imported from third countries. The granting of area status in these cases is based on some such principle as the value added by processing within the area, or the nature of the manufacturing process which the goods have gone through.

I mentioned the work of the Spaak Committee in Brussels. The Report of this Committee showed that the Six possessed more drive and determination than had been expected in some quarters, and the possibility that they would conclude a Treaty was becoming a certainty. Faced with this outlook, the British moved in the O.E.E.C. council that a working party study the possibility of establishing a free trade area which would include the Customs Union of the Six as one element.

Events moved fast during the first quarter of 1957. In January, the O.E.E.C. working party presented its report, which indicated the possibility of operating the Free Trade Area suggested by the British. In February, the British Government circulated a Memorandum to O.E.E.C. members setting out its views on the creation of an European Free Trade Area for industrial goods. The memorandum was also published as a White Paper. In March, the Six signed their own Treaties in Rome.

The momentum which had kept the Six moving on to this successful conclusion was conspicuously lacking in the negotiations that followed, at the urge of the British, for a 17 country Free Trade Area.

Several reasons account for this lack of enthusiasm. Trade and payments experts from the Six countries were exhausted by almost two years of work over the elaborate drafting of the Rome Treaty, with all its fine balancing of mutual concessions. Business in the six countries was starting with surprising readiness to adjust its plans to the Common Market to be. The association of 17 countries that was now being suggested would be not only much wider but much less definite than the Common Market; its impact would be more difficult to gauge, since each member country would retain its own tariff, and be allowed to change it. It was felt that, notwithstanding certificates of origin, this would provide loopholes for foreign goods to come into the area, and would distort the conditions of competition within it.

Resistance was specially strong in France, where it embraced Government, business and academic circles.

The negotiations dragged on for two years; they broke down in November 1958, after a final and dramatic clash between French and British representatives. The main development since then was the formation in November 1959 of a European Free Trade Association (E.F.T.A.) among seven countries: Great Britain, Denmark, Norway, Sweden, Switzerland, Portugal and Austria. The Association follows closely the lines of the Free Trade Area suggested by the British in their White Paper of February 1957. The members of the Association retain their individual tariffs, agricultural products are excluded from free trade, decisions are taken by unanimity rule except in complaint and escape clause procedures. The only governing body of the Association is a Council, in sharp contrast to the panoply of institutions in the Community of the Six, which include an Assembly, a Commission, a Council of Ministers, an Economic and Social Council, an Investment Bank and a Development Fund.

To sum up, out of 17 potential members of the abortive Free Trade Area, 13 are now organized in two trading blocs. Of the remaining four, Greece and Turkey have indicated a desire to be associated with the Six, probably with one eye to trade (mainly with Germany) and one to aid; Ireland and Iceland stand by.

There seems to be a general consensus of opinion that the present setup is not the optimal one. The Six are to all appearances less unhappy with it than the non-Six; however, even within the Six, a few leaders, like Erhard and Mendès-France, have been advocating a wider association.

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A realistic discussion of what the future may hold in store for Western Europe cannot be made purely in terms of economic factors, and I do not feel competent to introduce the political variables.

I shall therefore use a process similar to that of partial derivation in calculus, by assuming the political factors to be neutral and giving you a somewhat *unrealistic* discussion in terms of economic variables only.

To explain the limitations of this approach with one instance, I shall not include in my list of possible developments a breaking-up of the Common Market of the Six, because I do not consider that there are strong economic forces at work making for such a result.

Within this conceptual frame of reference, and looking forward to the next decade or so, I envisage four possibilities:

(1) the maintenance within Western Europe of two trading blocs;

(2) the breaking up of the Free Trade Association, some members of which would join the Common Market of the Six;

(3) an association of most or all Western European countries, in which the identity of the Free Trade Association would be lost;

(4) an association as above, in which the identity of *both* the present trading blocs would be lost.

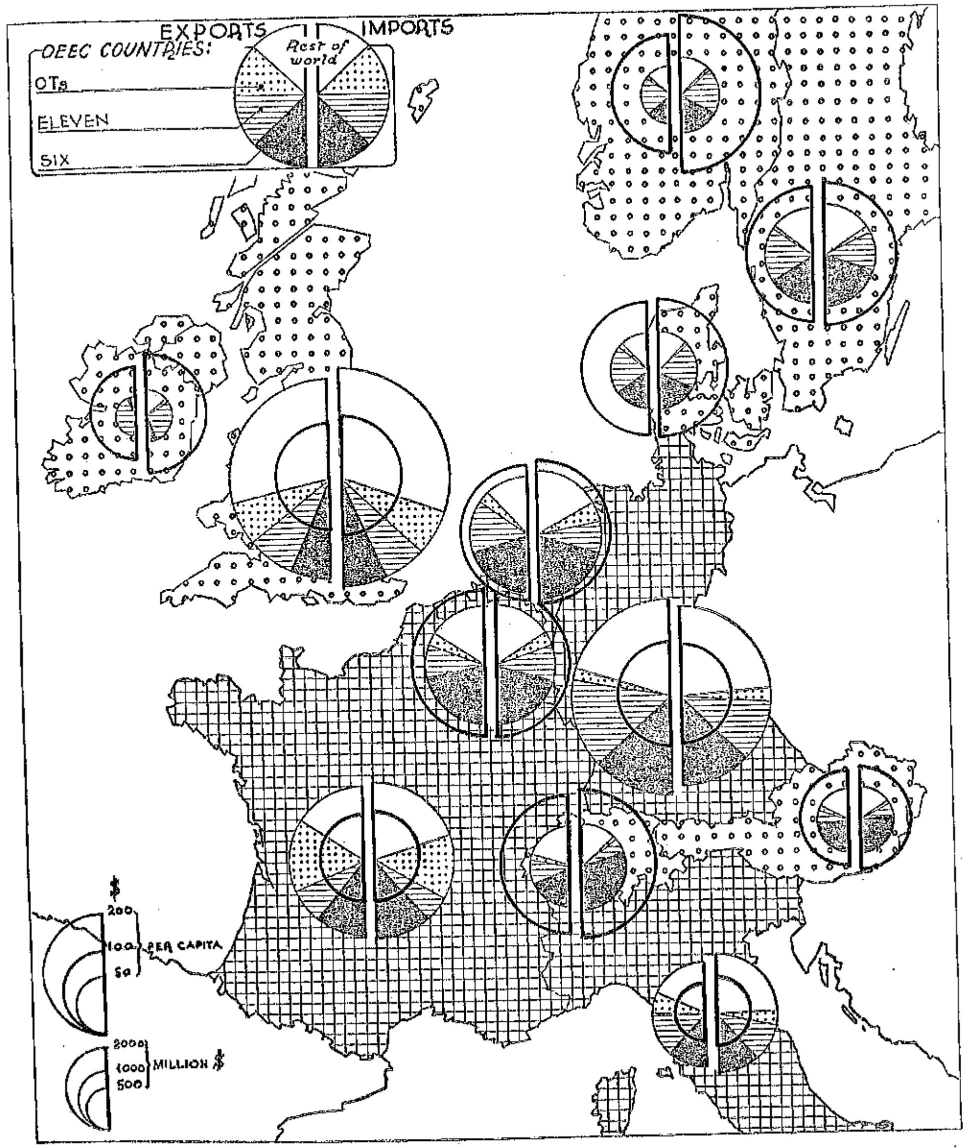
In the discussion of these possibilities we shall have some use for the following chart which is meant to illustrate the geographical pattern of trade of the O.E.E.C. countries. A few of them did not fit into it owing to their peripheral position — they are Greece, Turkey, Portugal and Iceland; they are all, tradewise, of little importance. Spain has joined O.E.E.C. quite recently and has been ignored for it was never considered as a potential member of the Free Trade Area.

The chart uses 1958 figures. The sectors shaded in blue give, for each country, the part of its total imports that are drawn from the Common Market of the Six, and the part of its total exports that are directed to the Common Market. It will be noticed that the blue colored sector is wider in the case of Germany and Germany's smaller neighbors, counting as such Austria, Switzerland, the Benelux countries and the three Scandinavian countries. Both for France and for Italy, the relative importance of trade with the Common Market is smaller, and it is smallest in the case of Great Britain.

The striped sector depicts trade with the rest of O.E.E.C., namely with the 11 O.E.E.C. countries that are not in the Common Market. The amplitude of the striped sector is greatest for Germany and for the Scandinavian countries. In the case of Germany, this reflects the importance of her trade connections with Scandinavia, Switzerland, Austria and the United Kingdom. In the case of the three Scandinavian countries, it reflects a high degree of trade integration within the Scandinavian area, and also the importance of their trade ties with the United Kingdom. But when we look at this relationship from the angle of the United Kingdom, we notice that her striped sector represents a *small* fraction of total British trade, and we find the same in the case of Switzerland and Austria.

The sum of the blue sector with the striped sector shows the trade with O.E.E.C. countries, Six and non-Six, taken together, except that trade with associated territories overseas is shown separately, by the dotted sector. It will be noticed that the importance

TWELVE OEEC COUNTRIES: TOTAL AND PER CAPITA FOREIGN TRADE 1958



Note - " OTs " stands for Overseas Territories associated with OEEC; " Eleven " stands for the OEEC countries which are not members of the European Economic Community, *i.e.* Austria, Denmark, Greece, Iceland, Ireland, Norway, Portugal, United Kingdom, Sweden, Switzerland, Turkey; " Six " stands for the European Economic Community countries, *i.e.* Belgium, Luxembourg, Netherlands, France, Germany, Italy.

of intra-European trade as thus defined is greatest for Germany and for her smaller neighbors. France trades to a larger extent with the rest of the world; the trade ties with associated territories overseas are specially important. The relative importance of intra-European trade is even lower for the United Kingdom which directs almost 50 per cent of its trade to the Commonwealth. The independent members of the Commonwealth are of course included in the blank sector.

In conclusion, the two countries which have come to be identified as the champions of two alternative approaches to Western European integration, namely Great Britain and France, are tradewise the least integrated into Europe. They do most of the arguing but it is Germany and its smaller neighbors that do most of the trade.

We are now provided with a minimum of factual knowledge to bring to the discussion of alternative future developments.

(1) I gave as a first possibility the persistence of the two trading blocs — the Six and the Seven. The probability of this happening is very small indeed. The Seven are a mixed bag of countries, which have been brought together by a need to bargain with the Six more than by anything else. Great Britain, with 60 per cent of the total population of the group, dwarfs the other six. There is no geographical continuity between them; on the contrary they occupy opposite corners in Western Europe. Apart from intra-Scandinavian trade and from trade between Scandinavia and Great Britain their mutual trade links are unimportant. Five of them, namely the three Scandinavian countries, Switzerland and Austria, gravitate towards the Common Market, and more especially towards Germany.

The Free Trade Association is aimed at preventing this gravitational pull from finding expression in bilateral deals with the Common Market. This was not exclusively a British fear. The three neutrals (namely Sweden, Austria and Switzerland) may have felt that the United Kingdom, as a member of N.A.T.O., enjoyed a greater freedom to negotiate some pact of association with the Common Market than they did.

As a result of the Free Trade Association, British exports will dislodge a few German exports from the Scandinavian markets, but possibly to no great extent, since Scandinavian tariffs are low. Swiss and Swedish exports of manufactures will acquire a somewhat larger share of the British market and a few British industries (such as paper and watches) may suffer severely. In a wider association of countries, there would be for any country more cases of competition from low cost foreign producers, but the effects would be distributed over a wider geographical area and local suffering would be less severe.

The Free Trade Association has shown its nature as a bargaining counter by indicating from the start a great readiness to negotiate a wider pact. For quota and tariff reductions, it has copied the time-table of the Rome Treaty.

If the negotiation between the two groups does not make satisfactory progress, the urge to conclude bilateral pacts with the Common Market will probably become irresistible.

(2) This takes us to the second possibility, namely the disruption of the Free Trade Association and the expansion of the Common Market to embrace new members. Of the seven Free Trade Association countries, Denmark looks like being the one for which the Common Market offers the greatest inducements to defection (though her close ties with the rest of Scandinavia may detain her).

Denmark is a member of N.A.T.O. and may be readier than a neutral to join a Community formed by six N.A.T.O. countries and intended as a step on the way to Federation. As an exporter of farm products, Denmark has strong trade ties both with Great Britain and with Germany; however, by entering the Common Market she would fetch higher prices than on the British market. In Britain, protection of farming interests has been reconciled with low prices of food for the consumers through a system of Exchequer subsidies to the British farmers, the so called " deficiency payments ", while the prices that exporters of foodstuffs get on the British market are by and large world market prices.

In contrast to the British system, protection of agriculture in Common Market countries is mainly based on tariffs and quotas. Official documents which have just been released provide striking evidence that the agricultural policy of the Community is moving in a strictly protectionist direction. The leading idea is to create a vast single market for agricultural goods, no less than for manufactures, and to insulate it from world market influences through a system of variable levies on imported farm products, superimposed upon the ordinary tariffs. The operation of such a system will presumably enhance price instability on the world market, while establishing inside the Community a farmers' paradise.

Any country specializing in exports of foodstuffs would stand to gain by joining such an area. The higher prices for the products of Denmark's farms would be paid largely by consumers in the rest of the Community; her terms of trade would improve; and this gain would more than offset the disadvantages of a shift in income distribution toward the land-owners and of higher costs in industrial activities. It will be interesting to watch the development of this chain of reactions in the case of the Netherlands, a low cost agricultural producer that is already inside the Common Market.

Switzerland and Austria trade but little with the remaining members of the Free Trade Association. In no material economic sense do they belong to the group of which for the time being they are part. They will tend to drop out and cultivate their natural relationships, as far as their neutrality policy will permit.

If this drift of the smaller countries towards the Common Market actually develops, the balance of power inside the Community will be substantially altered in favour of the German element, and the French may have reasons for some rethinking.

More generally, it may be observed that in an association embracing Western Europe as a whole a balance of power would be maintained with less difficulty. There would be more possibility for the will of a real majority or plurality of countries to emerge and to become generally accepted, in process of time, as the law of the group. Directional effects of policy actions would be less sharp, and accordingly less apt to antagonize individual members of the group.

(3) A Western European association including Great Britain, in which the present Free Trade Association would be dissolved, is number three in my list of alternative possibilities and number one in my assessment of probabilities. Such an association would presumably follow the lines of the old Free Trade Area suggestions.

British insistence on such a kind of arrangement is fully explainable in economic terms, which have been overtly stated, and it is, in my opinion, quite unwarranted to ascribe to Britain ulterior motives, such as that of holding back progress towards European unity.

Under the Ottawa agreements of 1932, the United Kingdom grants duty free entrance to most Commonwealth goods. Commonwealth countries, on their side, apply preferential duties to imports from the United Kingdom. Over 80 per cent of British exports to Canada, Australia, New Zealand and Rhodesia are accorded preference; for other Commonwealth countries, the percentage is lower. Altogether, one half of British exports to the Commonwealth is covered by preference. And the main stream of British exports flows to the Commonwealth. Many factors, of course, contribute with preferences to bring about this result — the existence of a sterling area, the flow of capital from London, and, more generally, the staying power of historical connections.

However, the extent of the preferential margins granted to British exports has been steadily falling since 1937, and the share of the Commonwealth in British trade has also been declining, so that the importance of the system of Imperial Preference is substantially smaller than during the thirties. Preferential margins have been reduced by Australia, Canada and other Commonwealth countries under bilateral agreements and through G.A.T.T. negotiations. The value of specific, as opposed to *ad valorem*, margins of preference has been cut by the general price increase. In an effort to industrialize, Commonwealth countries have applied import quotas that do not discriminate in favor of the United Kingdom, or raised duties against imports of manufactures to such an extent that British firms have often preferred to build factories behind the rising tariff walls.

While this happened to Commonwealth trade Continental Western Europe expanded at a faster rate than the sterling area and freed trade, gaining much ground over the Commonwealth as an outlet for British exports.

Policy decisions must take into account both present realities and prospective developments. In terms of present realities, the Commonwealth is more important for Britain than Continental Western Europe; in terms of prospective trade developments, the order of importance is reversed. It makes economic sense for Britain to preserve the trade ties with the Commonwealth while trying to establish closer ones with her ever more affluent European neighbors.

(4) Having this in mind, I attach a very low degree of probability to my fourth and last hypothetical development, namely the formation of a wider European association in which the Common Market

of the Six would lose its identity. I cannot easily imagine the Six foregoing their Common Tariff or Great Britain adopting it *vis-à-vis* the Commonwealth.

Negotiations will therefore move again, in my view, towards some Free Trade Area encompassing Western Europe as a whole. There will possibly be a change in the name, which is out of favor, matched with some change of substance: stronger institutions, greater harmonization of domestic policies and of external tariffs. In the meantime, British industrialists are left in the unenviable position of not knowing for how large a market to plan.

Measured in purely economic terms, the cost of Western Europe's present trade discord is moderate. The two groups have not yet coalesced. Intra-European trade flows more freely than at any time since 1913. Currencies are reasonably stable in terms of prices; they are stable in terms of each other and convertible into each other. A European currency would make little difference. Foreign immigrants are generally welcome owing to labor scarcity. A feeling of stability promotes investment abroad. Persons move across borders for business and pleasure in ever increasing numbers. We should not, therefore, expect great gains in productivity, and a marked acceleration of economic expansion, as a result of further integration. The gain to be reaped by establishing permanent economic bonds is rather to be seen in the avoidance of beggar-my-neighbor policies at times of economic difficulties, which the future may hold in store.

However, the Seven have good reasons to long for the building of a bridge. The Common Market countries are proceeding faster than was expected in welding their economies. The further they go, the more will negotiations with them become a matter of taking or leaving. Even with a good disposition on both sides to find a settlement, problems will grow bigger with time. I am thinking especially of the difficulty of merging the high price market for farm products which the Six are organizing with the British low price system.

And the good disposition has *not* always been there in the past. To give just one instance, during the Free Trade Area negotiations a Common Market authority came forward with the extraordinary suggestion of collecting on imports from Britain a special levy, calculated to offset the competitive advantage of cheap foodstuffs for the workers of British industry.

Europe may thrive in its present position, but if it does not move on quickly the path to unity may be lost. Some Europeans, on the side which for the time being is stronger, may even take an evil pleasure in the predicament of other Europeans. After all, we have been steeped in enmity for centuries.

A more generous disposition of mind will be required if future negotiations are not to get stuck again in the sort of quibbling that wrecked the first attempt at a Free Trade Area.

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