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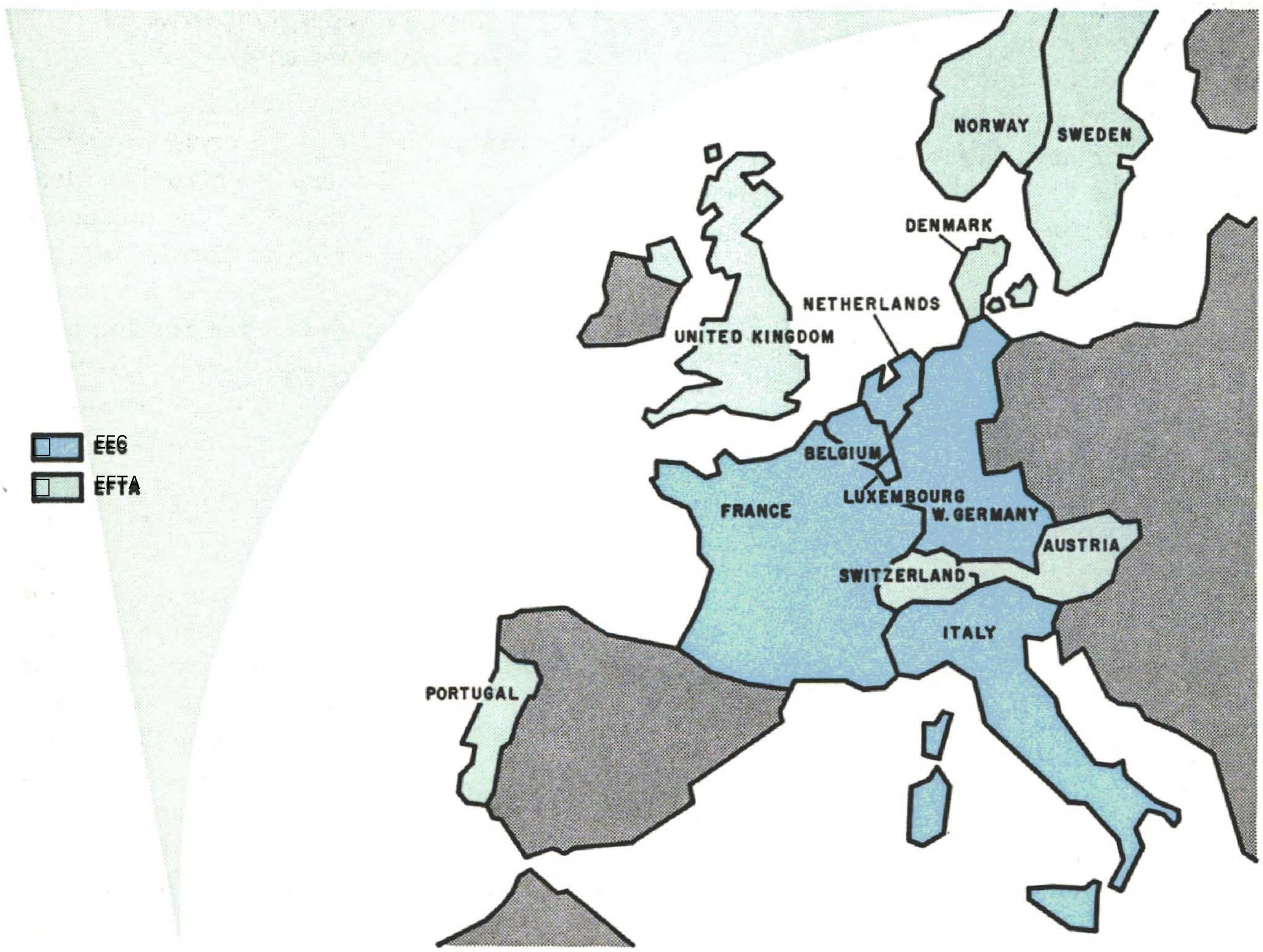
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# The European Common Market— Successful Launching of the First Stage

IN this age of missiles, the application of space age terminology to the European Economic Community (more popularly known as the European Common Market) is not inappropriate. The first stage of transition toward an integrated economy, composed of the six member countries of Belgium, France, Germany, Luxembourg, Italy, and the Netherlands, was successfully completed by the end of 1961, four years after its initial launching. The rapid rise in economic activity within the Common Market, moreover, can be likened to a successful take-off into the stratosphere. The second stage began this year with Common Market internal tariffs on industrial products 40 percent below their January 1, 1957 levels and the first 30 percent adjustment between individual country tariffs and the common external tariff in effect. A common agricultural policy was finally agreed upon in January, and progress is being made toward increased freedom of movement for labor, capital, and services and in the formulation of common policies in the fields of antitrust regulation, energy, and transport.

The establishment of the European Common Market on January 1, 1958 climaxed efforts over much of the postwar period first to continue and then to extend the close economic and political cooperation of the major European nations during the immediate postwar period of recovery and reconstruction. Its formation was designed to surmount some of the economic and technical problems presented by the existing market structure, to strengthen political ties, and to raise living standards in the area. Its objective is full economic union "cemented by common institutions—leading eventually to a United States of Europe"[1] to be attained through complete freedom of movement within the Common Market boundaries for goods, persons, services, and capital.

## The customs union moves toward closer political federation

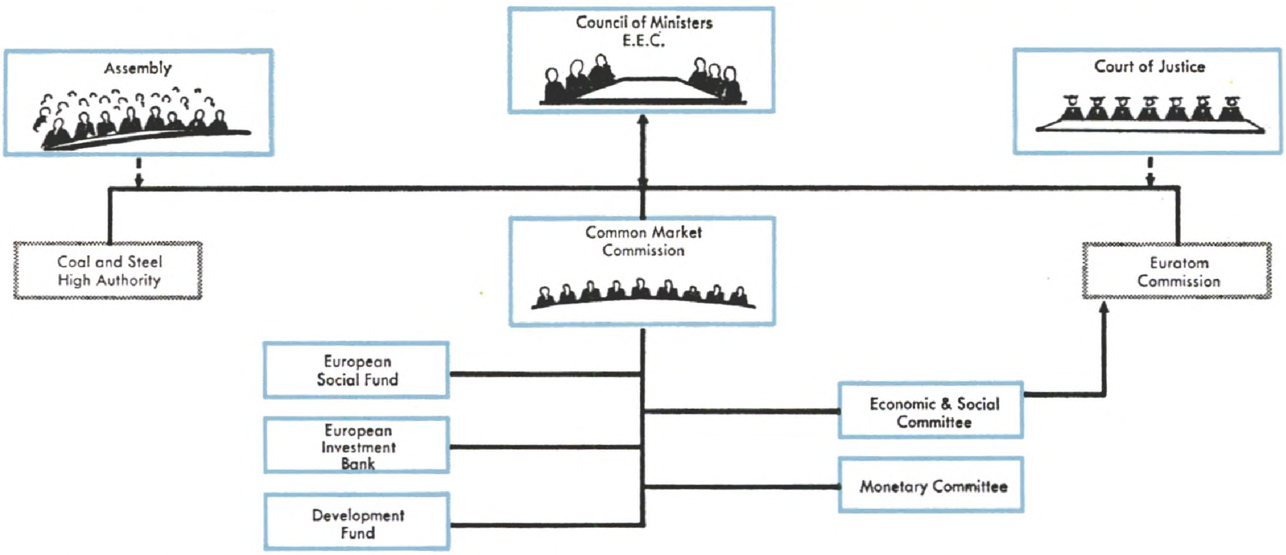
Much has been written about the structure and institutions of the European Common Market so only the main organizational features will be mentioned here. The remainder of the discussion will focus instead on some of the more important implications of the Common Market for both member and nonmember countries, especially the United States, with primary emphasis on broad economic considerations and commercial trade policy.

Essentially, the Common Market is a customs union with its own political institutions. The Rome Treaty setting up the Common Market does not set up any supra-national institutions completely independent of, or superior to, the member states. Individual nation states generally maintain their separate identities, and representation continues to be by country. But the members are moving toward closer political federation. For example, the Parliament, consisting of 142 members elected by the legislatures of member countries from within their own ranks, has recommended direct universal suffrage for selection of its members in the near future and enlargement of its size (Chart 1). Decisions on substantive matters by the six-member Council of Ministers, the principal decision-making body, are no longer taken by unanimous vote on a direct one-to-one national basis but by a voting system based on different weights for individual countries.[1] The seven judges of the Court of Justice,

[1]EEC Information Services, *The Common Market,* (September 1961).

[1]France, Germany, and Italy have 4 votes each; Belgium and the Netherlands, 2 votes each; and Luxembourg, 1 vote.

Chart 1: **Common Market institutions becoming more federal in structure.**




Source: Adapted from EEC Information Services, *The Common Market.*

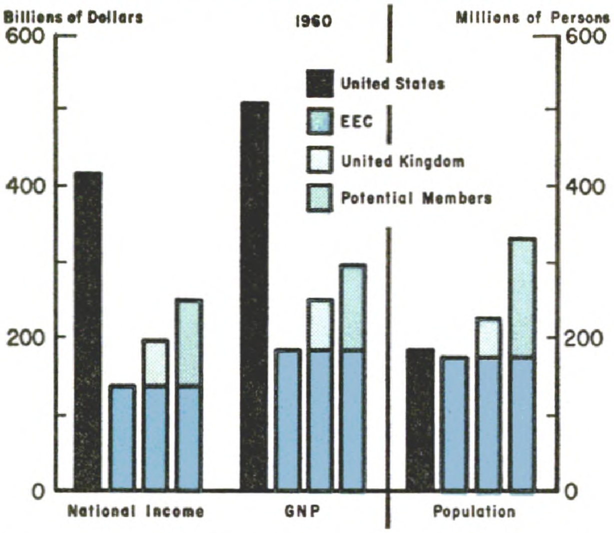
which exercises judicial control over the Community and is the final interpreter of Treaty provisions, are selected by the member countries acting in concert, as are the nine members of the Common Market Commission, the principal executive body. A number of subsidiary committees, such as the Economic and Social Committee and the Monetary Committee, and specialized intergovernmental agencies, such as the European Investment Bank, the Overseas Development Fund, and the European Social Fund, assist in implementing various aspects of the Common Market Treaty.

It might also be useful before discussing some of the broader implications of the Common Market to have some idea of the relative magnitudes involved when we talk about the Common Market. Although the land area encompassed by the Common Market countries is only about one-eighth that of the United States, their population numbers only about 10 million persons less. Nevertheless, gross national product and national income of the six Common Market countries were about one-third as large as that of the United States in 1960, although much larger than any other economic bloc (Chart 2). Even when the United Kingdom is admitted, the combined total will be only about half that of the United States. Consequently, even if present relative rates of growth are maintained, it will be some time before the output of the Common Market region approaches our current levels.

## Impact of internal tariff cuts on nonmembers less severe than percentage reductions might indicate

One phase of the Common Market arrangements that has received a great deal of attention is the steps being taken to form a customs union through the eventual elimination of internal tariffs on movements of goods within the Common Market and the alignment of the tariffs of the individual countries to a common external tariff on goods from nonmember countries. Chart 3 shows the original schedule for internal tariff reductions and the actual schedule as it has been modified by the EEC. The schedule drawn up to lower tariff barriers between member countries was accelerated to meet pressures arising from tariff reductions by the rival European Free Trade Association (EFTA)

Chart 2: **United States income and output significantly larger than that of Common Market countries in 1960.**




Note: Potential members include members of the European Free Trade Association, Ireland, Spain, Turkey, and Greece, which is an associate member of the EEC. GNP figures exclude Spain while the figures for Greece and Switzerland are for 1959. Sources: United Nations and Organization for Economic Cooperation and Development.

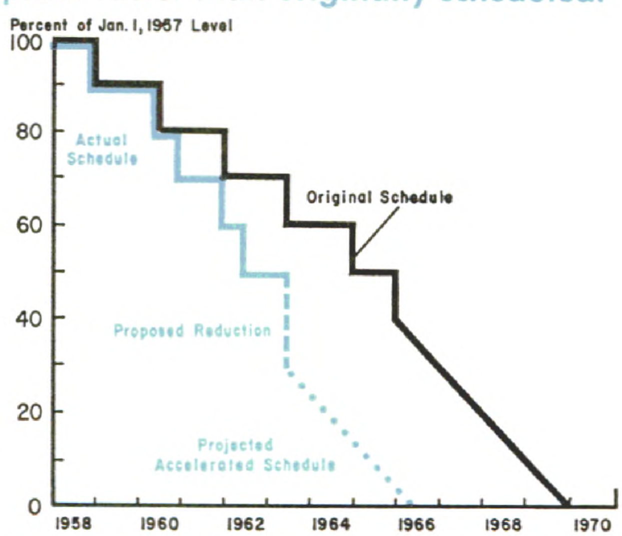
and because no major adverse repercussions were experienced by the Six in their internal markets. At the present time, internal tariffs on industrial goods have been cut to 50 percent of the base period level and to 65 percent on agricultural products not subject to intra-EEC quotas—two and a half years ahead of the original schedule. Another 10 percent reduction is programmed for July 1, 1963, with the possibility of further acceleration at that time. All internal quotas on industrial goods have also been abolished—eight years ahead of time.

The impact on third countries of the lowering of internal barriers, however, has been softened by a number of developments so that care must be exercised in using the percentage figures as a measure of the degree of discrimination against nonmember countries. The first 10 percent cut and a "major part" of the initial quota relaxation of 20 percent was generalized to all members of the General Agreement on Tariffs and Trade (GATT). In addition, Germany unilaterally reduced her tariffs by an average of 25 percent in August 1957 for all GATT members, which brought duties down below the first 10 percent cut. Subsequently, Benelux in July 1960 and France in December of the same year made smaller unilateral reductions in import duties levied on goods from nonmember countries. The rapid economic growth of the integrated area has also boosted imports from third countries significantly.

## Common external tariff still provides opportunities for trade expansion

For tariffs on imports from third countries, the first adjustment of member country tariffs was made one year ahead of schedule—on January 1, 1961—when differences between each country's tariffs and the common external tariff (CXT) were reduced by 30 percent. Adoption of the common external tariff in general increases the relatively low tariffs of the Benelux customs union, raises slightly present German tariffs (because of the August 1957 reductions), and lowers the tariffs of France and Italy, the two high-tariff countries in the Common Market. Another 30 percent adjustment will take place on July 1,

Chart 3: **Internal tariff cuts have taken place faster than originally scheduled.**




Sources: European Community, *The Common Market;* Emile Benoit, *Europe at Sixes and Sevens;* and Chase Manhattan Bank.

1963—two and a half years earlier than the original schedule — following the original phasing between internal and external tariff adjustments.

As in the case of the internal tariff reductions, the effect on nonmember countries of the alignment of external tariffs has been less severe than expected. In the first place, the generalization of the 10 percent internal tariff adjustment of 1959 to nonmembers reduced the overall level of the common external tariff. Secondly, an additional 20 percent reduction in the overall level of tariffs offered by the EEC in May 1960 on the basis of reciprocity was assured by the successful conclusion of negotiations at the GATT meetings last year. The United States obtained reductions equivalent to 20 percent on practically all its imports into the Common Market, except agricultural products[1] and some chemicals, affecting a larger volume of trade than that involved in concessions to the Common Market countries. Thirdly, the EEC has expressed its willingness to bargain for another 20 percent cut in the average level of the CXT in the near future. The United States will be able to participate in further negotiations if the President is granted the authority requested in the Trade Expansion Act of 1962 for new and broader tariff-cutting powers. Finally, the common external tariff is less restrictive of trade than the simple arithmetic averaging of rates that was used to arrive at the CXT might imply. The reductions in the high tariffs of France and Italy are much more significant in terms of potential increases in trade for third countries than possible shrinkages in trade due to the relatively small rise in low German and Benelux rates. Negotiations concerning the admission of the United Kingdom into the Common Market, moreover, are expected by a number of commentators to exert a liberalizing influence on the level of the common external tariff.

Generalizations regarding the impact of reductions in internal tariff barriers and realignment of external tariffs on the level of total trade, it might be noted, tend to obscure their effects on individual commodities. Some increases in rates may be relatively insignificant because they apply to commodities that are imported only in small quantities, while some increases may be just enough to eliminate narrow margins of profit. In other cases, the averaging of rates to obtain the common external tariff may as much as double the rate levied on imports into the most important market because of exceptionally high rates imposed by another member country. On the other hand, the lowering of highly restrictive duties permits development of new markets in countries previously considered poor prospects. Changes in market conditions of this nature, whatever the cause, are always confronting individual producers. Their adaptability in these situations provides a real test of their ability to compete effectively in the market place. It should be recognized, however, that quotas and other restrictions could effectively frustrate competition and render tariff levels meaningless. There has been considerable progress toward removal of barriers of this type, although the degree of relaxation varies from commodity to commodity.

## Growth rates within Common Market outstanding since 1958

The high growth rate of the Common Market economy since 1958 has been one of its outstanding features. Gross national product has risen from $161 billion to $191 billion in 1961—about 18 percent in physical volume, while industrial production has climbed by more than one-fourth (Chart 4). Plant and equipment expenditures have increased significantly, while capital formation has av-

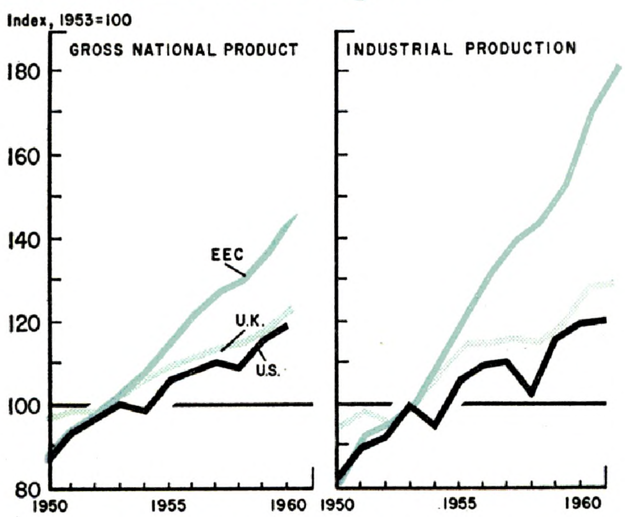
[1]Other than cotton, soybeans, tobacco, and vegetable imports.

eraged more than one-fifth of gross domestic product. Trade among the EEC countries has jumped by 75 percent, their balance of payments has moved into surplus, and prices have remained relatively stable. In contrast, gross national product and industrial production in both the United States and the United Kingdom have been growing more slowly, and both countries have been faced with payments deficits which are the counterpart of the EEC surpluses.

Although trade between EEC countries has increased sharply, other factors than tariff reductions have been more important to the area's rate of economic growth. The initial 10 percent tariff cut was relatively small, and the second reduction did not occur until 18 months later. The prospects of increased competition from within the Common Market and of a single large market stimulated trade and were largely responsible for the speedup in industry plans for modernization and rationalization. The expansion in trade reacted favorably on the level of domestic economic activity because of the importance of exports to the Common Market (almost one-fourth of GNP compared to 5 percent for the United States) and of trade between members, which accounts for one-third of total exports (Chart 5). Employment, consumption, and domestic investment as a consequence all rose in response to the quickening tempo of economic activity; unemployment rates fell to minimal levels in most member states; and labor shortages appeared. Payments surpluses emerged under these favorable conditions.

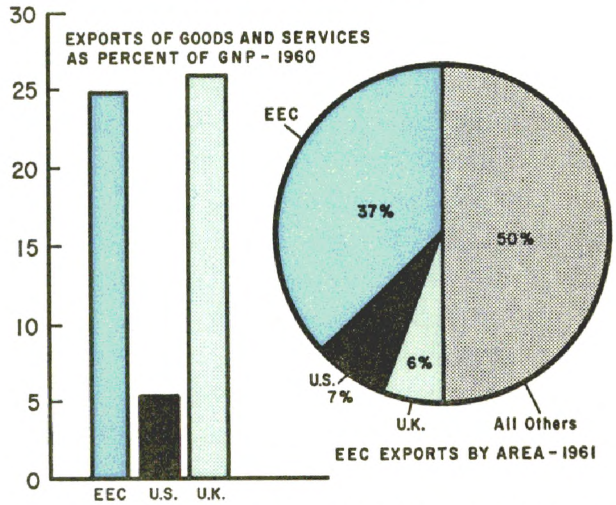
Thus, the economic expansion of the Common Market countries has to a significant extent been due to the establishment of the customs union and associated arrangements. But the Common Market also benefited from the high growth rates of the years immediately preceding its formation, which contributed a great deal to its success (see Chart 4). The cyclical upswing of 1953-57 was bolstered by the recovery of European productive capacity and the re-entry of European producers into world markets. When the Common Market formally came into existence in 1958, the brief lull in the economic expansion had passed, available European productive

Chart 4: Economic growth of Common Market more rapid than in United States and United Kingdom.




Source: Organization for Economic Cooperation and Development.

Chart 5: Foreign trade—and intra-area trade in particular—very important to Common Market countries.




Source: Organization for Economic Cooperation and Development.

capacity was more than adequate, price inflation had been brought under control, and labor was in ample supply. These propitious conditions got the Common Market off to a rousing start, while organization of the Common Market itself tended to reinforce the upswing in the economies of the member countries. In the future, however, as shortages of labor and price pressures limit physical expansion, the Common Market countries may have to depend more on the introduction of innovations and development of new technology to stimulate the economy. The close relationship between foreign trade and economic activity in the Common Market countries, moreover, will always tend to assure maximum leverage from any growth in intra-EEC trade and vice versa.

## The entry of the United Kingdom into the Common Market

Two issues that have been prominent in the news lately in connection with the Common Market are the negotiations regarding the entry of the United Kingdom and the common agricultural policy agreed upon by the members in January 1962. The admission of the United Kingdom would bring the Community's gross national product to about $250 billion and its population to almost 225 million (see Chart 2). The enlargement of EEC membership by the addition of the United Kingdom should increase both the industrial capabilities of the region and its diversity, while the higher per capita income of the United Kingdom should boost the level of consumer demand. But at least three major problems must be solved before Britain's accession: the treatment of agricultural commodities, many of which currently enter Britain duty-free; the position of the Commonwealth countries and the status of Commonwealth preferences; and accommodation of Britain's European Free Trade Association partners. Although the inclusion of the United Kingdom theoretically widens the area of trade discrimination against third countries, United Kingdom membership may result in more liberal treatment of a number of industrial raw materials and foodstuffs because of the current low levels of British tariffs on these products. If preferential treatment is accorded certain commodities produced in the Commonwealth, however, nonmembers will tend to be placed at a disadvantage.

## A restrictive common agricultural policy

Agreement on a common agricultural policy proved to be one of the thorniest problems facing the European Economic Community. As a consequence, substantive agreement was not reached until January 1962. Among the stumbling blocks were reconciliation of the varied forms of government support maintained by the member governments, conflicting attitudes on farm policy arising from the differing roles of members as exporters or importers of agricultural products, and wide variations in farm cost and price structures.

Because the Common Market is a major dollar outlet for United States agricultural products, accounting for $1.1 billion in purchases in fiscal 1961 or 22 percent of our total farm exports and almost one-third of our exports of agricultural products for dollars, the EEC's agricultural policy is of utmost interest to the United States. The farm sector is the sector of our economy most dependent on exports; 15 percent of farm output is marketed abroad. The Twelfth District is also vitally interested in the treatment to be accorded a number of important agricultural commodities (including fresh and processed fruits and vegetables, cotton, nuts, and wine) which find sizable markets within the Common Market. The admission of the United Kingdom to membership would further boost our stake in the Common Market's agricultural policy since total Community agricultural imports from the United States would then account for almost one-third of our total farm exports and 46 percent of our dollar exports of these commodities.

Although United States agricultural production in many lines is highly efficient and competitive, our farm products can be effectively shut out from foreign markets by various import barriers erected to protect domestic price support systems. Certain farm items produced abroad have encountered similar treatment in this country. At the present time, the Common Market's agricultural policy seems to lean in the direction of restrictiveness as does its complete or partial exemption of most agricultural products from both the internal and external tariff adjustments that have taken place. The principal provisions of the common agricultural policy proclaimed in January, to be put into effect during a seven-and-a-half year transition period, include: equalization of support prices among member states; establishment of an Agricultural Fund to finance adjustment programs, to subsidize export of agricultural surpluses, and to intervene in support of prices; and a system of Community preferences for EEC agriculture based on variable import levies. In addition to a common external tariff, moreover, fears have been expressed that additional discrimination against the products of nonmembers may occur through strict application of grading standards and other administrative regulations. This aspect of an otherwise liberal Common Market policy has therefore been one of the most disappointing to nonmember countries. The question might also be asked whether this kind of policy is the best solution for both the Common Market and the rest of the world.

The problems of European agriculture are deep-seated, of long standing, and not particularly amenable to any quick solution. For example, in the six Common Market countries there are 9 million farms on 40 million acres (5.5 million of which are less than 12 acres), compared to 5 million farms in the United States with 400 million acres under cultivation. There is one farm worker for every 2.7 acres in the EEC compared to one for every 53.3 acres in this country. There is the danger that protection may lead to perpetuation of existing inefficiencies. But the common agricultural policy is not necessarily final in its present form; modifications in the direction of greater liberality are still possible. United Kingdom accession to the Common Market, for example, may improve the prospects for United States agricultural exports because of the British policy of passing on low world food prices to the consumer while making compensatory income payments to the farmers. The United Kingdom, however, has agreed in principle to accept the Community's common agricultural policy, with provision for annual review of the agricultural situation in Britain. But important issues such as treatment of temperate foodstuffs supplied by the Commonwealth countries have yet to be settled. As in the case of industrial products, moreover, the more liberal and flexible our own trade and tariff policy, the better the chances are that the Common Market's agricultural policy will be relaxed and that both producing and consuming countries may share in expanding markets and lower prices.

## Economic integration a net advantage to members

Although the advantages and disadvantages of economic integration to members and nonmembers have been widely discussed, no definitive conclusions have been reached. The formation of a customs union creates larger internal markets, which permit industries and firms to reap the advantages of economy of scale and to benefit from the stimulus of increased competition. It encourages greater specialization along the lines of comparative advantage, at least within the integrated area, resulting in better utilization and allocation of labor and other factors of production. Keener competition in turn tends to weed out the marginal, high-cost producers —without eliminating an internal source of supply for particular commodities—and increases economic efficiency in general. As a consequence, productivity and income increase. The net gain from economic integration due to the creation of trade within the customs union and better utilization of resources can also be increased through a rise in consumption and investment as the size of the market expands. These dynamic effects of integration in turn generate still higher levels of income, productivity, and trade.

Economic welfare *within* an economic union is also enhanced to the extent that economic efficiency is maximized. If purchases are diverted from low-cost producers outside the customs area to higher cost, protected producers within the protected region, however, there is a loss in real welfare to the inhabitants of the Community. On the other hand, increased protection from a common external tariff might eventually permit a limited number of domestic industries to achieve lower costs of production equaling or exceeding those of the excluded nonmember.

So far, despite the rapid economic growth of the EEC, the experience of the Common Market seems to indicate that the expansionary impact of the integration process itself may be somewhat less than theory suggests. Expansion, for example, has been dampened by more specialization and reallocation of resources within countries rather than between them, by continued high levels of trade with nonmembers, and by a smaller scope for movement toward production at optimum levels than expected (because a number of firms and industries are already operating at close to optimum levels). National differences in tastes have also tended to persist, keeping markets fragmented to some extent. Nevertheless, trade, income, and other indicators of economic activity have all risen within the Common Market, partly because of economic union but also partly because of the favorable conditions under which the Community developed. On balance, members of the Community have benefited from the larger volume of trade and higher levels of productivity and income which have offset losses in welfare resulting from the diversion of trade away from nonmembers.

## Direct benefits of integration to nonmembers uncertain

Whether nonmember countries gain from economic integration is less certain. For the United States, for example, there is the direct loss of trade where trade is diverted from this country to member countries. The actual volume of trade so affected, however, has probably been relatively small to date because many United States industrial raw material exports to Europe are admitted into the Common Market at low or duty-free rates while others are not produced in the Common Market in sufficient volume to meet demand. In another group of commodities, such as certain advanced types of capital equipment and consumer goods, the United States continues to hold the edge on the basis of comparative cost or technological superiority. The adverse impact of economic union on nonmember countries is greater the higher the common external tariff and the larger the volume of trade between member and nonmember countries. Because the average level of the common external tariff has been lowered through recent actions and because the volume of trade between countries of the Common Market is large, the disadvantages for third countries tend to be less marked.

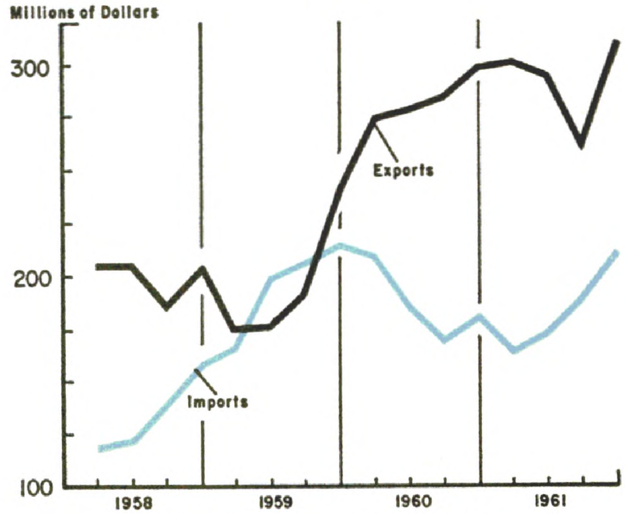
Improvement over the longer run in the Common Market's productivity and real income, on the other hand, provides a larger market for imports from nonmembers of industrial raw materials, food, and consumer goods, especially if productive capacity in the Common Market lags behind the growth in income. The competitive position of outside suppliers, however, may deteriorate both because of the continued existence of tariff barriers on goods from nonmembers and because of increased efficiency within the EEC. These same factors may also help to facilitate adoption of a more liberal commercial policy by the Community. The net effect is hard to measure.

Less directly related but nonetheless important is the fact that economic integration fosters a stronger, more viable economic unit, minimizing potential sources of disturbance to the world economy, and a region which is in a better position to extend assistance to economically underdeveloped countries and assume a larger share of the financial burdens for mutual defense. On balance, therefore, the Common Market can be favorable for third countries if losses from the diversion of trade are more than counterbalanced by increased trade arising from higher productivity and incomes within the economically integrated area and by the indirect gains stemming from strengthening of the Community.

The United States, for example, has obviously shared in the recent economic growth of Europe, as witnessed by the 40 percent increase in exports to the area from 1958 to 1961, while imports from the Six rose only 25 percent (Chart 6). In periods of booming activity in Europe, the United States becomes an important marginal supplier, especially of industrial raw materials. Rising living standards in the Common Market provide another promising market for United States

Chart 6: **United States exports to the Common Market have risen faster than our purchases there.**

(monthly averages)




Source: Organization for Economic Cooperation and Development.

consumer products. The rapid economic expansion of the Six has stimulated direct investments in Europe by American firms; dollar volume rose from $173 million in continental Western Europe in 1958 to $962 million in 1960 and $664 million in 1961. Private United States investors have also indicated their confidence in the Common Market's economic potential by increasing their portfolio and short-term investments in the Common Market countries, although the restoration of nonresident convertibility for the major European currencies at the end of 1958 undoubtedly contributed to the significant rise in capital outflow to Europe.

As economic integration progresses within the Common Market, its influence on the United States will be revealed in a number of different ways. The commodity composition of our trade may change as protected industries inside the Community displace imports, as new capacity is installed or as agricultural self-sufficiency is increased. Individual products may find traditional outlets closed, while others may find their markets growing. The competitive position of individual producers thus will change. There is little evidence, however, to support the thesis that United States producers are being generally outpriced by their competitors within the Common Market. A study by the National Industrial Conference Board has concluded that higher wage costs in the United States are oftentimes offset by higher materials costs abroad.[1] In third markets, United States manufacturers may also find more competition in terms of prices, quality, delivery times, and credit. Performance of United States exporters in foreign markets recently, however, has been encouraging.

## Summary and conclusions

The preceding discussion has touched on only a few of the numerous issues raised by the Common Market—issues, however, that are particularly crucial at this stage of its development. Producers and traders of nonmember countries tend to suffer from the increase in discrimination but benefit indirectly from the rise in productivity and incomes within the Common Market. From the viewpoint of the Common Market itself and of the world as a whole, the Common Market constitutes a net gain as long as productive efficiency and international specialization are increased. Some of the remarkable progress within the Community, however, has been due to the particularly auspicious conditions under which it came into existence. Once these favorable conditions weaken, progress may be somewhat slower, especially as capacity limits are reached.

The generally liberal orientation of the Common Market has tended to soften its adverse impact on the rest of the world. The benefits of increased international specialization within the area, moreover, are transmitted to other countries through Common Market exports; not only must countries import in order to export, but countries import to gain the benefits accruing from production based on the principle of comparative advantage. The Common Market is here to stay and provides both the United States and other countries with a challenge and an opportunity.

[1]National Industrial Conference Board, *Costs and Competition—American Experience Abroad* (1961) and *Production Costs Here and Abroad* (1958).