The economic impact of the ECM on the Inner Six

"Formation of the Common Market did not bring about the rapid rate of economic growth in Europe; rather, Europe's rapid rate of growth made the Common Market possible. "This observation was made by Prof. Harry Johnson of the Economic Department of the University of Chicago at the Mount Allison Summer Institute in August of this year. Prior to Johnson's mild bombshell, the Institute participants, who were discussing the broad subject of "Canada, the Commonwealth, and the Common Market," had appeared to accept without dissent the proposition that the formation of a Common Market would inevitably increase the economic welfare of the member nations.

In support of this idea, had not the "Reader's Digest" just published a list of "before and after" prices, showing dramitically how the formation of the European Common Market had lowered substanially the the prices of a number of consumer goods? Did not everybody know that by creating a "mass market" of 170 million persons the Common Market would enable European manufacturers to duplicate American production techniques, and, thereby, the American standard of living? Surely it was obvious that the increased competition which would result from reduction in tariffs could be nothing but beneficial? And anyway, the "wind of change" sweeping over Europe would so revitalize the Old World that, with hard work, low taxes and cooperative trade unions, the millenium would be just around the corner.

Academically Obtuse?

With all of these arguments, Dr. Johnson begged leave to differ. In the space available, I propose to discuss more fully some of these points in an attempt to assess whether Johnson was simply being academically obtuse in refusing to accept the "common-sense-man-of-the-world" point of view, or whether he had a real point to make.

Valid Reasons

There are a number of valid reasons for supposing that the formation of a Common Market might be economically beneficial to the participating countries. (The question as to whether and to what extent these benefits may be at the expense of outsiders is another question, of course). The two defining characteristics of a "common market" from an economic point of view are (1) an agreement among members to eliminate all tariffs on goods transported from one member country to another, and (2) an agreement that all members will impose the same tariff rate on goods moving into the common market area from outside. As many people have pointed out, the six countries (France, Germany, Italy, Belgium, the Netherlands, and Luxembourg) which signed the Rome Treaty on March 25, 1957, have made commitments which go beyond mere agreements to adjust tariff rates, and for this reason the term "European Economic Community" (E.E.C.) is probably a more meaningful designation than "European Common Market." However, up to the present time the implementation of the Rome Treaty has been largely confined to those sections dealing with tariff adjustments. Implementations of the provisions relating to the common transport policy, the free movement of labour and capital, and the coordination of national monetary and fiscal policies, has been slight. For this reason, attention here will be focused upon the effects of reducing tariff barriers.

Proponents of the case for the economic benefits of customs unions use a multitude of arguments but it is impossible to isolate three of the most important. For ease of reference they can be labelled the "economies of scale" argument, the "benefits of competition" argument and the "psychological impact" argument.

The "economics of scale" argument, as indeed are each of the others, is perfectly straightforward and plausible. Modern techniques of production for many commodities are such that low unit costs can be achieved only by producing a large output. By increasing the size or "scale" of a factory, a manufacturer can install assembly-line techniques that will enable him to employ labour most efficiently, and he can make use of specialized and expensive capital equipment. Although total installation or "overhead" costs will be high, the "overhead" cost per unit of the product in question will be low if a sufficient volume of output produced.

Under certain conditions, the larger the output, the lower will be the final cost of production per unit, and hence the lower the price paid by the consumer. However, a manufacturer faced wiht a small domestic market may not be able to produce at a level of output large enough to reduce his average production costs to a minimum. Enlarge the potential market of this manufacturer by participating in a "common market" venture and, so the argument goes, he will respond by producing a larger output at a lower cost per unit, thereby enhancing the economic welfare of the community.

"Benefits of Competition"

The "benefits of competition" argument is not an argument along "Capitalism vs Socialism" lines, as some might imagine, but rather an argument along even hoarier battle-lines, "Free Trade vs Protection." Generally speaking, and with certain exception, tariffs give rise to an uneconomic allocation of scarce resources since they encourage manufacturers to produce products which can be produced at a lower cost somewhere else. The so-called "tariff-wall" prevents the foreign manufacturer from underselling his domestic counterpart, the consumer paying in the form of higher prices for the privilege of keeping the high-cost producer in business. Removal of the tariff, it is argued, forces the domestic producer to meet foreign competition or to go out of business, and either way to reduce costs, in the latter he will have found a more productive line of work to which to devote his talents. Moreover, consumers gain from reduced prices.

The "psychological impact" argument, as I have termed it, is somewhat less mechanical and precise in its implications, but nevertheless it too can be articulated in a simple way which is not too much of a caricature. Businessmen, feeling that the formation of a common market is bound to give rise to an increase in the incomes of most individuals, increase their expenditures on plant and equipment in order to have factories ready to meet the additional requirements of the lucky recipients. As any post-1936 graduate of Economics 1 should know, increased expenditure on factories will itself give rise to an increase in national income. Therefore, even though the Common Market "by itself" may have no expansionary effect on national income, because businessmen thought it would have had an effect in this direction it will have such an effect.

Having gone this far, adding along the way certain qualifications and amendments which in no way change the substance of the argument many writers proceed to trot out a number of figures which show that, since the inception of the European Common Market on January 1, 1958, the economies of the six countries involved all have experienced rates of growth which are substantial, impressive and some multiple (usually two) of some other country's growth rate. (The other country is either the US or the UK: occasionally, however, one reads "Canada" at this point.) With a brief farewell not to the arguments which led the reader to anticipate this happy conclusion, the author concludes with the pious expression of a hope for even larger growth rates in the future.

Ask For Yourself

In order to avoid cluttering up the page with numbers, the reader is invited to check for himself that the growth rates of the Six have in fact been substantial and impressive, and double Canada's growth rate since 1958. As any post-350 B.C. graduate of Philosophy 1 should know, however, "post hoc" arguments of this type often prove treacherous. The present example is no exception. The growth rates of the Common Market countries were equally impressive prior to 1958, and, lest someone claim that this merely proves the efficacy of the "phychological impact" argument, rates of growth were high, even prior to June 1955, the earliest date at which anyone could reasonably have anticipated the formation of the Common Market. The high growth rates subsequent to 1958 do not, therefore, provide conclusive proof of the beneficial economic effects of the Common Market, since an equally impressive performance was registered before 1958. In fact, one author, Mr. Lamfalussey of Belgium, has shown that after one allows for various cyclical influences, it is not possible to say that the Common Market has had **any** detectable effect upon the growth rates.

What, then, is one to make of the various arguments outlined above which purport to show that the formation of a Common Market would have a beneficial impact? The answer would appear to be that while logically sound, their empirical significance is slight. "Economies of scale" will increase productivity if there are any economies to be exploited. However, most of the countries forming the Common Market are in themselves large enough to enable manufacturers to take full advantage of the economies of mass production. Countries with populations of tens of millions are sufficiently large to support most industries, the main exceptions being atomic energy and commercial aircraft. The "benefits of competition" accruing from the lowering of trade barriers will tend to improve the allocation of resources, as consumers switch from high to low-cost producers, but in the over-all picture the net result may be small. Johnson has calculated that, should Britain join the Common Market, the total "once-for-all" gain from this source would be about 5% of its national income, and Scitovsky has estimated an even smaller gain for Continental countries. (See The Free Trade Proposals, ed G. D. N. Worswick, Basil Blackwell, Oxford, 1960, p 136). Finally, although its very nature prevents an accurate measurement of its effect, the "Psychological impact" argument taken by itself neglects the other factors which contributed to Europe's investment boom throughout the whole period of the 1950's.

Useful Key

Two thoughts will be presented in concluding. The second part of Johnson's comment, to the effect that Europe's expansion made the Common Market possible, provides a useful key to understanding the ease with which the whole affair was consummated. Economic prosperity not only made it easier for any disturbance and adjustments to be smoothed out, but it also sweetened somewhat the political implications of the Rome Treaty. Finally, the arguments put forward by the British Government in support of its application to pin the E.E.C. are relevant to the general theme presented here: a careful reading of the Government's case does not reveal any precise statement as the economic benefits to be derived by Britain from closer association with the Six, nor does the Government seem at all confident that there will be any net gain worth speaking it. This approach may be dictated by Britain's peculiar position vis-a-vis Six and the Commonwealth. It may also, however, be a realistic appraisal of the situation.

A. M. Sinclair, Assistant Professor of Economics at Dalhousie, is a native Haligonian, born in 1936. He studied at Dalhousie where he received his B.A. Following this he read for his B. Phil degree at Oxford. He is now engaged in working towards his Ph.D. at Harvard.

McGill Conference on World Affairs:

Problems of the Common Market

(From the Mc Gill Daily)

The European Trade Union has done extremely well up to date, with respect to growth and trade, but the crucial problem still remains unanswered: Will the European Common Market and the countries outside it ever achieve a balance of trade?

Professor S. E. Harris, Professor of Political Economy at Harvard, explained why the problem is so acute at the first session of MCWA last night. As a background, he gave statistics to show how much better the West European countries, collectively, have fared in the last seven years than either Britain, Canada, or the United States.

The problems amongst the countries themselves, such as France's high tariff on manufactured goods, and Germany's high tariff on agricultural products, have been more or less settled. But the problems of the United Kingdom and of the United States and Canada involve their whole trade balance.

In general, a country which does well will export more than it imports, and this will tend to produce an unfavorable balance of payments. The European countries do not have this problem, partly because of the economic revolution that has taken place, and partly because they trade amongst themselves.

Developed Stable System

The European countries have developed a stable economic system for many reasons. There has been an increase in the size of the business unit, which reduces the cost of production, and goods have been produced more effectively. The United States has sent in capital, trained technologists, and the tourist trade. The large countries outside this trade union are beginning to feel its growth and are preparing either to fight the Market or to co-operate with it.

In expectation of the effect of the European Common Market, the United States has introduced its "trade expansion program" which will change the trade policy to provide negotiation with the Market. Parts of this program include reducing the tariff between the USA and other countries by 50% within 5 years; and eventually completely eliminating tariffs where the USA and the Common Market countries control 80% of the trade.

The United States has fared poorly over the last seven years in comparison with the trade expansion of the countries of Western Europe. Methods to change this state of affairs have not yet been successfully devised.

Devaluation Suggested

The devaluation of American currency in terms of French or German money has been suggested, and refused for various reasons; the prestige of the government would fall. Russia and South Africa would receive a subsidy if the price of gold increased, and the European countries might not be cooperative.

Further suggestions to step up the trade of the States include making additional reserves available, and setting up an international trade organization. Neither of these have been put into effect.

The United Kingdom faces loss of trade with the Commonwealth nations if it joins the Common Market, and thus it is very hesitant about entering. It only started to consider the possibility of entering after the Trade Union was well formed, and this put it at a disadvantage.

Britain stated that they were a higher wage country than any of the West European countries. Today, this argument no longer holds water, as Italy is the only country which has a relatively low wage per hour.

Protected by Trade

Some Commonwealth countries will be protected by their large trade, such as Canada, which exports $4,000,000 worth of wheat each year. But Australia, whose wheat is less in quantity and poorer in quality, will suffer through the high export tariff which Britain will be forced to impose on her.

This Common Market tariff would reduce the special privileges Britain now gives the Commonwealth countries, and would raise the prices of the commodities which Britain receives from these countries. The only benefit Britain would acquire would be a reduction in taxes on foreign goods.

The final point to be considered is the benefit of the Common Market to the under-developed countries. One economist states, "The United Kingdom program is to help the rich West European countries, at the expense of the under-developed ones." This may well be true and constitutes another of the many problems that the European Common Market will have to resolve before it can be completely effective and successful.