This report is restricted to use within the Bank.

66992

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

EUROPEAN INTEGRATION, CONVERTIBILITY
AND THE DOLLAR SHORTAGE

March 7, 1950

Economic Department
Prepared by: K. Varvaressos
R. Zafiriou
March 23, 1958

SUBJECT: VARIATION IN POPULATION, GROWTH AND THE DOLLAR CRISIS

By: K. Varveracos and F. Zafiriou

ACKNOWLEDGMENTS

3. Page 13, 3rd line of paragraph 1: "in determining the" instead of "in determining the".

2. Page 51, 3rd line of paragraph 2: "Western Europe" instead of "Western Germany".

3. Page 60, 1st line of paragraph 2: "countries make the" instead of "countries make the".

5. Page 62, 16th line of paragraph 1: "essential materials" instead of "essential material".

5. Page 69, 10th line of paragraph 1: "the proportion of" instead of "the proportion of".

6. Page 86, 3rd line of paragraph 1: "capacity to make" instead of "capacity to use".

7. Page 92, 3rd line of paragraph 2: "The same applies" instead of "The same applied".

8. Page 106, 17th line of paragraph 1: "world's largest importer" instead of "world's largest importer".
## CONTENTS

**INTRODUCTION** .................................................................................................................. 1

A. NATURE OF EUROPEAN PROBLEM ................................................................................. 2

B. EUROPEAN ECONOMIC INTEGRATION .......................................................................... 6

1. The demand for integration is based on a comparison with American conditions .......... 6

2. The relation between the size of the American market and American economic development ......................................................... 9

3. The causes of Europe's present weakness ................................................................ 14

4. The solution of Europe's difficulties ...................................................................... 17

5. Integration as a solution to Europe's difficulties .................................................. 18

6. The freeing of intra-European trade as a means of integrating the European economy .......................................................................................................................... 22

   Quantitative trade restrictions since the war ......................................................... 22

   Intra-European exchanges before the Great Depression ...................................... 24

   Intra-European exchanges during the 1930's ....................................................... 29

   The removal of quantitative restrictions in intra-European trade .............................. 34

   The removal of quantitative restrictions alone will not produce a single European market - Other conditions required .......... 38

7. The cost of Economic Integration .............................................................................. 44

   Dislocation of European economy and greater need for American aid ................. 45

   The danger of German domination of Europe ..................................................... 51

   The creation of permanent discrimination in world trade ....................................... 52

8. Increased competition in intra-European trade and the proposals for a European Payments Union ................................................................. 58

   "Integration" in the limited sense of freer exchanges within Europe ....................... 58

   Intra-European exchanges since the end of the war ........................................... 61

(continued)
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>The ECA proposals for a European Payments Union</td>
<td>67</td>
</tr>
<tr>
<td>Prospects of adoption of the ECA proposals for a European Payments Union</td>
<td>81</td>
</tr>
<tr>
<td>The need for a broader approach to the problem of European payments</td>
<td>83</td>
</tr>
<tr>
<td>C. THE DOLLAR SHORTAGE AND CONVERTIBILITY</td>
<td>88</td>
</tr>
<tr>
<td>1. Progress in European production and trade</td>
<td>88</td>
</tr>
<tr>
<td>2. European plans and prospects</td>
<td>100</td>
</tr>
<tr>
<td>3. Implications of European plans for world trade and the world economy</td>
<td>105</td>
</tr>
<tr>
<td>4. Conclusions</td>
<td>107</td>
</tr>
</tbody>
</table>
INTRODUCTION

One of the most significant developments in 1949 has been the general realization that Europe's dependence on American assistance is not being reduced at the rate necessary to make the region self-supporting by 1952. As a result, earlier optimism has given place to doubts and to a reconsideration, on both sides of the Atlantic, of the issues involved in European recovery.

In Europe the attainment of production levels higher than pre-war is interpreted as evidence that the region's production problem has by now been solved and that its inability to balance its accounts with the United States merely reflects the American refusal to accept the necessary volume of imports. The corollary of this interpretation is that American aid to Europe is the inevitable price that the United States must pay for its economic policies, and as such, must be continued as long as these policies remain unchanged. The 1952 deadline is considered an arbitrary date which bears little relation to economic realities.

In the United States the failure of these increases in European production to reflect themselves in smaller European dependence on American aid is interpreted as evidence that European production must be increased still further and must be made more competitive. This, it is held, can come about only through the integration of the European economy.

As always, there is some truth in both contentions. What makes these divergences in interpretation so disturbing at the present moment is that each side considers its own interpretation as the whole and only truth and tends to act on that premise. The result is that instead of real agreement on policies in which both sides believe and which both sides intend to carry out, there is at present a tendency to be satisfied with words and let the pull of
conflicting forces act as the only arbiter. This accounts for the confusion and uncertainty which at present prevail in the economic relations of the Western World. It is no exaggeration to say that clear thinking is one of the most urgent needs of the moment. The purpose of this Memorandum is to discuss the issues involved and contribute to their clarification.

A.—NATURE OF EUROPEAN PROBLEM

In our view, it is unrealistic to consider the present difficulties facing the group of ECA countries as a single problem which can yield to a single formula. What is called the "European" problem is in fact an aggregation of special, mostly unrelated, problems confronting a number of independent countries whom the Americans, projecting their own experiences, have decided to treat as a distinct political and economic entity.

The truth of this statement is easy to demonstrate:

American assistance to Europe since the inception of the European Recovery Program has been distributed as follows between the individual European countries:

ECA Aid April 3, 1948 to September 30, 1949

<table>
<thead>
<tr>
<th>Country</th>
<th>(Million $)</th>
<th>(Percent of Total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>1,896.9</td>
<td>27.1</td>
</tr>
<tr>
<td>France</td>
<td>1,505.6</td>
<td>21.4</td>
</tr>
<tr>
<td>Western Germany</td>
<td>697.1</td>
<td>10.0</td>
</tr>
<tr>
<td>Netherlands</td>
<td>642.9</td>
<td>9.2</td>
</tr>
<tr>
<td>Italy</td>
<td>778.6</td>
<td>11.2</td>
</tr>
<tr>
<td>Belgium</td>
<td>366.5</td>
<td>5.3</td>
</tr>
<tr>
<td>Denmark</td>
<td>152.9</td>
<td>2.2</td>
</tr>
<tr>
<td>Sweden</td>
<td>60.6</td>
<td>0.9</td>
</tr>
<tr>
<td>Norway</td>
<td>128.5</td>
<td>1.8</td>
</tr>
<tr>
<td>Greece</td>
<td>236.1</td>
<td>3.4</td>
</tr>
<tr>
<td>Austria</td>
<td>328.9</td>
<td>4.7</td>
</tr>
<tr>
<td>Turkey</td>
<td>34.0</td>
<td>0.8</td>
</tr>
<tr>
<td></td>
<td>6,956.3</td>
<td></td>
</tr>
</tbody>
</table>

1/ Excluding aid granted directly through occupation authorities.
This table shows that 58 per cent of the total was accounted for by the three major European countries, namely the United Kingdom, France and Germany, and another 20 per cent by the Netherlands and Italy. Thus, from the quantitative point of view, the European Recovery Program is overwhelmingly a program of assistance to these countries. Until 1948 it was possible to argue that the deficits had a common origin, namely the destruction and dislocation of war, and called for a common solution, namely the making good of war-time losses. The persistence of the deficits in 1949, when production and trade had returned to or even exceeded pre-war levels, can no longer leave any doubt that the external disequilibrium of these countries is not to be explained in terms of exceptional reconstruction needs alone. An examination of the factors which account for this continued unbalance shows that they differ so widely from country to country as to make any generalization about the "European" dollar deficit largely meaningless.

The British deficit epitomizes all the strains and stresses to which post-war British policies have subjected the country's economy. The excessive repayment of war-time debts, the huge outflow of capital, the large military expenditures and the inflationary pressures generated by over-full employment and costly social reforms go a very long way towards explaining Britain's continued external unbalance, and they are all produced by circumstances peculiar to post-war Britain. The loss of investment income has no doubt been a factor of great importance, but an expansion of exports to 150 per cent of pre-war and the holding down of imports to only 85 per cent of pre-war should have more than offset this loss. There is a school of thought which considers that Britain's real problem is the inadequacy of her resources due to inadequate productivity, and that the real answer to Britain's difficulties lies in higher productivity. This assumes that productivity is an independent
factor which can be manipulated at will by governments and business. In fact, the level of productivity is part and parcel of a country's economic structure, attitudes and policies, and can be influenced only through changes in those basic features of the economy. Britain's problem for the next few years will be how to cut down excessive claims on her resources and thus be able to live within her means. It is a specifically British problem which calls primarily for changes in British policies. An increase in the size of British resources through increased productivity can come about only gradually and only to the extent that the British population is willing to put up the extra effort required. It is at best a distant prospect and cannot, therefore, be considered as a solution on which a country that wishes to regain her independence and self-respect can pin her hopes.

The French deficit is largely the product of the country's financial instability, which is in turn a by-product of the tensions and antagonisms prevailing in French society. The striking improvement in the French balance of payments in 1949 following the improvement in French internal finances has conclusively shown that the main obstacle to French solvency is the inflationary pressure resulting from these internal strains which can be eliminated only through French action.

The deficit of Western Germany is primarily a consequence of defeat and partition and of the loss of supplies traditionally obtained in Eastern Germany and Eastern Europe. It is, therefore, a German problem depending for its solution primarily on German developments.

The deficits of the other countries similarly reflect weaknesses which are specific to each country and which can be removed only by appropriate national action.

The main thing these countries have in common is that they are all
recipients of exceptional American aid. This aid is granted to them not because they are an indivisible regional group facing a common problem, but because they happen to be countries which the United States has found it to be in its political and economic interest to help. That membership in the group is largely accidental and was primarily determined by political considerations can be seen from the fact that countries like Poland and Finland, which are as hard-pressed for aid and are as much part of the European group as any other European country, are excluded, while countries like Portugal and Turkey, which were not affected by the war and of which one at least is not even part of Europe, are included. Nor is there any economic justification for leaving Spain out of the group.

It might be argued that there is something which all these countries have in common and which calls for American aid, and this is their persistent dollar deficits. These, it might be said, cannot be eliminated without drastic economic adjustments, which cannot be carried out unless substantial outside aid is forthcoming.

This argument overlooks the following facts: (a) Not all these countries need to carry out drastic readjustments in their economies. The position of countries like Sweden, Portugal, Turkey is much more similar to those of non-European countries like South Africa, Australia, Egypt than of countries like Britain and France. Switzerland, which is as much part of Europe as any ECA country, neither needs nor receives American aid. (b) Dollar deficits are not confined to Europe alone. Practically every region in the world finds itself in an unbalanced position vis-a-vis the United States. In 1948, for instance, ERP countries accounted for only 55 per cent of the total American surplus on current account. (c) Dollar deficits often merely reflect the fact that exceptional resources, either in the form of grants or in the form of reserves, were available to finance an import surplus from the dollar area.
Thus, Czechoslovakia's trade deficit with the United States, which was $87.5 million in 1946 and $19 million in 1947, was reduced to only $13 million in 1948 simply because exceptional American aid came to an end. There can be little doubt that participation in the Marshall Plan would have brought more aid to Czechoslovakia and would consequently have increased her dollar deficit. Yugoslavia, which, until her break with the Soviet Union, had a balanced external position, developed deficits almost simultaneously with the increased possibilities of obtaining American aid. In our view, a part at least of the dollar deficits of other European countries is of the same nature. But there is also another reason why the relation between American aid and European need for that aid is not as clear-cut as is usually assumed. The availability of aid often removes the pressure to take action for closing the dollar gap and thus becomes one of the main causes of the need for such aid.

Another criterion for differentiating the ECA countries as a group might be sought in the seriousness of the Communist threat to which all these countries are exposed as a result of their social instability and the proximity of the Soviet Union. Such a criterion, however, clearly does not apply to countries like Britain, Sweden or Portugal, and even in the case of more vulnerable countries like France, Italy or Greece it is a moot point how far the alternative to less aid would have been Communism or a greater sense of responsibility among the governing classes.

It is, therefore, probably truer to say that European countries are a special group because they receive American aid than that they receive aid because they are a special group.

B. EUROPEAN ECONOMIC INTEGRATION

1. The demand for integration is based on a comparison with American conditions.

The American insistence that integration is the answer to the problems facing these countries ignores the realities of the European economic and
political situation. The real European problem, as far as Americans are concerned, is to balance accounts with non-European regions and especially the dollar area. This is so because it is the lack of balance in these accounts which creates the need for exceptional American aid. The other European problems, and they are many and difficult, are problems for the Europeans to face and solve in accordance with their own ideas and their own abilities.

Europe is not the only region faced with serious problems of adjustment. The United States itself is not exempt from such problems, witness the growing difficulties which it faces in carrying out its agricultural policies. Because the European Recovery Program has focused attention on Europe's problems and difficulties, there is a tendency to exaggerate their magnitude and portray the European economy as suffering from a fatal debilitation which only unprecedented remedies can cure.

In fact, the problem of Europe's solvency is primarily a problem of expanding exports to or reducing imports from non-European regions, and since the magnitudes involved in this adjustment are small, (the gap in European external accounts corresponds to less than 2 per cent of the total income of the group), the restoration of external balance calls mainly for adjustments in production and trade that will enable European countries to sell more of their goods in Western Hemisphere markets. In relation to Europe's total production and trade these are marginal adjustments which can unquestionably be made within the framework of Europe's present economic organization.

Unfortunately, Americans have tended to interpret Europe's difficulties in quasi-metaphysical terms as involving a choice between a completely new start and virtual extinction. This, no doubt, reflects the American passion for "bigness" in everything, including problems, as well as the appeal which

1/ Total output of goods and services in ERP countries in 1949 is estimated by OECD at $160 billion. The deficit in 1950 will be $3 billion.
challenging situations make to American energy and imagination. A basic weakness in this approach is that the job of reorganization which Americans urge on Europe is a job which must be carried out not by the Americans but by the Europeans themselves, i.e., by people who neither accept the American interpretation of their difficulties nor share the American zeal for far-reaching changes in their lives.

But apart from the fact that "integration" is not wanted by the Europeans, it is also an objective which is impossible of realization and which, in fact, conflicts directly with the major aim of the ECA program, namely the restoration of Europe's independence from American aid in the next few years.

A discussion of the arguments advanced in favor of integration will show why this is so.

Americans who maintain that integration is the only solution to Europe's difficulties recognize that the region's most urgent problem is the closing of the dollar gap and that this is also the principal object of ECA aid. They consider, however, that so long as European productivity remains at its present levels, the balancing of Europe's dollar accounts will be neither possible nor sufficient to ensure economic and political stability in the region. This is so, they say, for two reasons: (a) In order to sell abroad in large quantities European goods must be produced more cheaply than they are at present. Lowering prices through devaluation is no enduring solution since devaluation means higher import prices and hence higher costs of production. Only increased productivity can make European goods competitive in world markets. (b) Even if the effort to sell abroad or do without dollar goods is successful, Europe's existence will continue to be a precarious one so long as living standards remain at their present levels. And since a rise in those standards depends entirely on a rise in productivity, increased productivity constitutes the only real answer to Europe's difficulties.
According to this diagnosis, European productivity compares unfavorably with American productivity because Europe, unlike the United States, has not availed itself of the opportunity of using mass production methods for the cheapening of its output. This in turn is attributed to the smallness of local markets in Europe as compared with the vast continental market of the United States and the conclusion is drawn that, if only Europe could be transformed into a single market, modern methods of production would immediately become profitable and the stage would be set for a tremendous expansion in output, reproducing the pattern of the American achievement. This would not only mean higher living standards for all, it might also bring about the region's political unification, since an economically unified Europe is likely to realize much better than it does now that its political divisions are equally antiquated. When this happens, Europe's weaknesses will disappear and its true potentialities as a region second to none in resources and skills will be fully exploited.

Few ideas have appealed more to the American mind in recent years than this vision of a Europe made strong and prosperous through unification. It has all the fascination of a success story built on American experience. To many Americans the size of their country appears such a decisive factor in the greatness they have attained as a nation that becoming bigger seems to them the sure recipe for acquiring strength and wealth. Hence the tendency to view smaller countries with a kind of commiseration and to ascribe to their smallness any weaknesses they may happen to exhibit.

2.--The relation between the size of the American market and American economic development.

Unfortunately the whole idea is based on a greatly oversimplified version of American economic development. To attribute the high level of American productivity to the size of the American market alone is to single out one factor among the many which have gone to make American productivity what it is
today. This interpretation ignores, for instance, that the United States covers an area twice as large as that of ECA countries and has a population only half as large. It is, moreover, an area which includes some of the world’s most productive land as well as vast mineral resources. Americans like to stress the advantage which they derive from being a nation 150 million strong. Europeans are more impressed by the fact that such a large area is inhabited by only 150 million people. When a country is so liberally endowed with natural resources one does not have to look very far for the explanation of its prosperity. There is no large internal market in sparsely populated areas like Canada, Australia and New Zealand to explain their high standard of living, but the abundance of good land which resourceful and energetic people have put to good use is a sufficient explanation.

The second fact which is often ignored is that it took American industry more than a hundred years to exploit the advantages offered by the existence of a large internal market. Until 1914 American manufactures as a whole were not competitive with European manufactures. This is shown, first, by the continued pressure for protection against foreign competition and, second, by the fact that American industry was still unable to sell its products to foreign countries on any substantial scale. American industrial supremacy is a relatively recent phenomenon, and as such, cannot be solely attributed to the advantage of a large internal market which has existed from the outset.

Another thing to remember is that the adoption of mass production techniques by American industry has been due as much to the high cost of American labor as to the size of the American market. American real wages have always been higher than European because access to virtually free land made workers less dependent on industrial employment than in Europe. During

1/ In 1913 American exports of manufactures amounted to $1,184 million as compared with a total trade in manufactures which may be estimated at some $9 to $10 billion.
the period of Britain's unchallenged industrial supremacy British workers earned less and enjoyed a much lower standard of living than their American counterparts, although American industry was still in its infancy and its products were no match for the corresponding British goods. The high cost of American labor has been the standard argument of industrialists in favor of protection, but it has also been one of the main factors responsible for the introduction of labor-saving machinery and the standardization of goods which led to the development of mass-production techniques. It is a great mistake to assume that because these techniques reduce costs in a country where labor is expensive and capital and managerial skill plentiful they could do the same in countries where these conditions do not obtain. It must also be remembered that standardization of production requires a corresponding standardization of tastes and demand which was easier to achieve in a new and undifferentiated society like the American than in an old and stratified society like the European.

Finally, no explanation of present American economic superiority is complete which ignores the differences in the attitude to business and work prevailing in the United States as compared with Europe. A country settled by individuals who had refused to accept the poverty and lack of opportunity of the old world and were determined to improve their material position in new and freer surroundings was bound to produce a different kind of business man, farmer or worker from those found in Europe. There is no equivalent in Europe to the typical American business man with his overflowing energy and confidence and his infinite capacity for work. Similarly, there is no equivalent in Europe to the typical American farmer or worker whose willingness to adopt new processes and to change occupation in response to changed conditions of production or consumption contrasts so sharply with the conservatism of their European counterparts. Nor is it surprising that individuals pursuing their
economic betterment as single-mindedly as Americans have done since they established themselves in their new country would in the end prove more successful in the field of material production than people who by disposition and tradition were less intent on getting ahead in life. This human factor is probably as important as any other in explaining present American economic superiority.

The size of the internal market has played a part in the economic development of the United States to the extent that it has ensured a high degree of uniformity in consumer demand and thereby enabled American industry, handicapped by high labor costs, to adopt mass production techniques which reduce labor costs per unit of output. It has also ensured to American producers the benefits of a uniform monetary, legal and administrative system. But if the existence of a large internal market alone had been sufficient to produce a great economic expansion, India and China would by now have been the most highly developed countries in the world. And inversely, small countries like Switzerland and Belgium would have had no chance of survival. As a matter of fact, the size of a country's internal market has little to do with the efficiency of its industry. It is not the internal market by the total market for a product that determines the conditions under which it will be produced. The Swiss possess the most efficient watch industry in the world not because they have a large internal market for watches, but because special skills developed through the centuries and other favorable conditions enable them to excel in that particular industrial pursuit and thus dispose of a large proportion of their output in foreign markets. The Belgians have achieved a high degree of efficiency in the production of certain types of steel, machinery, chemicals and textiles, and can comfortably outsell their competitors, many of whom are favored by a much larger internal market.
range of high quality goods enables her to supply not only her own needs but also those of millions of customers in other countries. For several of these industries the size of the internal market is irrelevant in determining the scale of their operations or the total demand for their products. It may be estimated that at the beginning of the 20th century nearly one-third of European manufactures were sold in foreign countries. It is exactly because European industry was geared to produce for the world market that it has suffered so greatly from the trade barriers which non-industrial countries have erected during the last two decades against imports of manufactures. The American industry, on the other hand, was scarcely affected by this fall in world demand for manufactures not only because its exports consisted primarily of heavy industrial goods which suffered less in world trade than other manufactures, but also because it had depended far less on foreign markets for the sale of its output than European industry. Finally, the size of the American market has not been able to make a relatively inefficient American industry, like wool-growing or watch-making, into an efficient one and has not removed the need for heavy protection or even outright subsidization from a wide range of American industries.

The exaggerated importance which Americans attach to the internal market reflects the diffidence with which a traditionally protectionist people view the world market and the dependence on other countries which producing for the world market entails. From the point of view of national security and stability, a large internal market is unquestionably preferable to a large share in the world market, but such independence necessarily means less international specialization, a less efficient use of world resources and a smaller volume of world trade. Whatever the other advantages of a large internal market as compared with the world market, higher productivity is certainly not one of them.
Our conclusion is that the causal relationship which is said to exist between the size of the American market and the American standard of living is, at best, a very partial one. The United States owes its present economic pre-eminence to a variety of factors, among which large natural resources and the willingness of its people to work hard for their material improvement are probably the most decisive. Inversely, the present European weakness has little to do with the size of the European market.

3.—The causes of Europe's present weakness.

We have already tried to explain the causes of that weakness\(^1\) and do not wish to repeat the argument here. We shall only give a brief summary of our thesis.

While Europe could rely on cheap labor for low-cost production and while there was a large foreign demand for the type of goods thus produced, European industry was supreme and European financial strength remained unrivalled. The challenge to this preeminence came after the First World War, and it came both from within and from without. Labor's increased strength meant a less cheap and less docile working force, hence higher production costs and loss of competitive advantages. Management, made complacent by a century of industrial supremacy, lacked the vision and energy to adapt its production methods to this new situation, and, instead, sought to retrieve its position through restrictions, cartels, price fixing, increased protection against foreign goods and preferential treatment in foreign markets. At the same time, the greatly increased taxation of high incomes reduced the incentive to invest.

While internal developments were thus making European products less competitive in world markets, external developments were working in the same

---

\(^1\) Memorandum on the Prospects of European Recovery under the Marshall Plan, February 9, 1948.
Memorandum on the Prospects of European Recovery, November 17, 1948.
direction. The emergence of the United States and Japan as great industrial powers meant that the world demand for manufactures was no longer a European preserve. The advantages of these new industrial countries over Europe were two-fold: (a) Coming later in the industrial field, they were able to develop their industries on the basis of the most up-to-date techniques and equipment, and (b) their industrial leaders brought to the job the drive and energy which their European counterparts had shown a century earlier but which they gradually lost. Another outside blow to European industry was the rapid development of light industries in regions which had previously relied on European products for the satisfaction of their needs. Considering that light industrial goods had been the mainstay of European exports, this change in demand greatly reduced the export opportunities of European industry.

The depression of the 1930's helped to conceal both the causes and the effects of this weakening of Europe's position in the world economy. When demand falls as seriously short of supply as it did in the 1930's and competition degenerates into a cut-throat struggle for shrinking markets, there are no valid criteria for judging an industry's efficiency. It was, therefore, plausible for Europe to attribute its selling difficulties to the world depression and not to any special weakness of its industry. At the same time, the depression helped to conceal the effects of Europe's industrial decline on its external financial position because it helped to keep down the demand for imports and enabled Europe to obtain these imports at extremely low prices. Finally, the gold reserves and foreign investments accumulated during a century of prosperity were sufficiently large to allow Europe to carry on for a considerable time without experiencing any serious difficulties in its external payments.

The war, in addition to the direct losses and dislocations it inflicted on the European economy, has also had the effect of removing the factors which during the depression had concealed the existence of a balance of payments
problem in the major European countries. The large gold and foreign holdings were liquidated or lost. Prices of primary products not only returned to their pre-depression relationship with the prices of manufactures, but in many cases rose to unprecedented heights. The disparity between European and American productivity further increased. The industrialization of primary producing areas, which made huge strides during the war, reduced the demand for Europe's traditional exports and diverted a large part of the purchases of these areas to the United States, which was better equipped than Europe to meet the new demand for producers' goods emanating from these areas.

Internal developments intensified these external weaknesses. With the disappearance of unemployment, European output increased by a substantial amount as compared with pre-war, but the claims on this output increased by a still greater amount. Full employment strengthened the position of labor and resulted in a considerable increase in workers' earnings, which was not attended by a corresponding increase in productivity. The promises of reforms made during the war necessitated vast government expenditures on social services and other benefits for the low-income groups. Moreover, dissatisfaction with pre-war standards of living was such that these improvements by no means satisfied the working class and the pressure for new gains remained. The neglect of the 1930's had also to be made good in the field of investment and has necessitated large expenditures for reequipment and modernization of industry and agriculture. Finally, unsettled world conditions have forced these countries to maintain a military establishment far in excess of peace-time standards. Even when fully employed, the available resources have proved insufficient to meet all these claims made upon them. Hence the persistence of inflationary pressures, which, by reducing Europe's ability to compete in foreign markets and meet the needs of its foreign suppliers, have done so much to hinder the restoration of external equilibrium. Thus, the European economy is caught in a vicious circle of
internal weakness producing external weakness, and external weakness intensifying internal strains. American aid has temporarily broken the circle, but it is obvious that a more permanent solution to the difficulty must be found.

4. The solution of Europe's difficulties.

The question which is now being debated is whether such a solution is possible within the present framework of the European economic organization or whether a complete overhaul of the European economy is required before the region can regain its economic independence. Our contention is two-fold: (a) European countries can solve their problems without having to sacrifice their present economic independence. (b) The attempt to "integrate" the economies of the various European countries would for a considerable time make things worse, not better, for most of these countries.

The fact that American aid represents such a small fraction of the total income of the group is a clear indication that the problem of becoming independent of that aid is of manageable proportions. The fact that Western Europe has been able to achieve such a considerable degree of financial and social stabilization through the use of that aid is evidence of the marginal nature of the adjustments required to overcome present European difficulties.

As already stated, the problems facing each European country are different and call for different solutions, but they all have to do with the need for greater incentives and greater flexibility in the internal economy, more careful government spending and a more determined effort to sell in dollar markets. In 1949 total exports of ERP countries amounted to $18 billion and imports to $20 billion. Exports to the United States and Canada were only $1.1 billion and imports $4.3 billion. If Europe could sell another $1 billion in the United States and do without $2 billion worth of American goods, the problem of her dependence on American aid would disappear. This would require an increase in total European exports of only 5 per cent and a reduction in imports of only
However difficult or unpleasant, these are aims which are well within the capacity of European countries to achieve.

As regards the improvement in living standards on which European political and social stability ultimately depends, it is only if no possibility existed for expanding production in the various European countries that a case could be made for a reorganization of the European economy on an entirely different basis. In fact, all the available evidence suggests that in practically all European countries there is considerable scope for increases in production. Management is not doing all it can to introduce modern techniques of production and increase efficiency. Labor is not working as hard or as long as it could. Obsolete equipment is not being replaced at the rate required to bring European industrial efficiency up to date. If European policies were directed towards inducing such changes, the problem of Europe's solvency and standard of living would cease to exist. It is difficult to believe that production cannot be organized efficiently unless consumers number 150 million. A home market of 50 million and the vast Commonwealth markets which are available to Britain seem large enough to permit efficient production in British industry. Similarly, is it correct to call a market of 70 million in Germany and of over 50 million in France and her overseas territories "small local markets"?

5.—Integration as a solution to Europe's difficulties.

But let us assume that the various European countries cannot or do not want to take the steps necessary to increase the productivity of their industries. Would the integration of their economies be the answer to the problem of selling more to and buying less from the dollar area? Would such integration result in a higher volume of production than is likely to obtain under the present structure of the European economy and hence in a higher standard of living for the European population?

The term "integration" has been so loosely used in the last two years
that it has come to mean anything from a mere consultation between governments to a complete merger of the economies of European countries. The result has been utter confusion of thought and action and the advocacy of the most contradictory policies. Before proceeding to discuss the issue of European "integration" it is, therefore, essential to be quite clear about what is meant by "integration".

As already stated, "integration" is believed to be the answer to Europe's problem because it is expected to lead to larger-scale production, greater specialization, and hence lower costs of production in European industry. This can happen only if the number of industries in each country decreases and the size of the industries increases, for it is only thus that the benefits of large-scale production can be realized. If the removal of restrictions in intra-European trade does not result in such a reorganization of European industry, this can mean only one of two things: either that there is no scope for improvements in European productivity through the enlargement of European markets, or that the restrictions that have been removed were not the only ones impeding the establishment of a single market in Europe.

In our view, even if Europe became a single market, it is unlikely that European industry would, for a considerable time, find it profitable to introduce mass production methods on the scale prevailing in the United States. We must keep in mind that labor is more plentiful in Europe than in the United States, capital and natural resources scarcer and consumer tastes and demand more diversified, which means that the scope for mass production is smaller in Europe than in the United States. The creation of a single European market would, no doubt, eliminate the most inefficient producers, and thereby reduce production costs, but this would be unlikely to happen on a scale that would revolutionize European industry. It is more probable that a single European market would still be a market where production would be on a small scale as compared with the United States, and where the bulk of national industries would
continue in existence in spite of the loss of protection against the competition of other European industries. Protection on the scale practiced by industrial countries is usually needed by marginal producers rather than by a whole industry and the removal of such protection is not likely to lead to a complete abandonment of production in that industry, but only to a contraction of its activities. This is so because no country can become as highly industrialized as Western European countries are unless it possesses important advantages in overall industrial productivity. There is, for instance, no reason to suppose that the creation of a single market in Europe would obliterate the French steel industry or Dutch shipbuilding in favor of the corresponding German or British industries because there is no reason to suppose that all French steel production and all Dutch shipbuilding are inefficient as compared with the German or British. What is probable is that a large proportion of the French steel industry and Dutch shipbuilding would remain in business and would be able to withstand British and German competition.

If Americans stopped to think of how the tariff operates in their own economy, it would be easier for them to realize how greatly they exaggerate when they maintain that trade restrictions within Europe are the main cause of low European productivity. The American tariff and the other obstacles erected in the United States against imports are more effective in keeping foreign goods out of the American market than any restrictive devices invented by European or other countries. The proof of this can be seen in the fact that imports represent a smaller proportion of national income in the United States than in any other country besides Russia. In spite of this excessive protection accorded to American industry, there is no reason to believe that the removal of barriers against imports would produce any radical changes in the structure of the American economy. What would probably happen is that the least efficient industries would contract and the more efficient ones would expand, but all this would take place
within limits and would in most cases affect marginal producers rather than a whole industry. Over-all American productivity would, no doubt, increase, but as compared with the increases in productivity due to other causes such an increase would probably be modest and would for some time be offset by the dislocation and hardship that would result from such a reorganization of production. It is exactly because no spectacular gains in living standards can be expected from the elimination of tariffs and other trade restrictions that countries are usually unwilling to take the plunge and impose hardships on some sections of their population for the sake of benefits to the community which cannot be measured and which are instinctively felt not to be worth the dislocation that will be created. When so much importance is today being attached to trade restrictions as a cause of low living standards, it is well to remember that protectionism has not prevented the United States or Germany from becoming leading industrial countries, nor has free trade prevented Britain's industrial decline. The truth is that tariffs and trade restrictions usually operate at the margin and that other factors are more important in determining a country's economic development and standard of living than the regime of its economic relations with foreign countries. Similarly, trade restrictions are often the consequence rather than the cause of economic weakness.

If these considerations are taken into account, there is little justification for expecting a transformation of the European scene through the elimination of restrictions in one sector of European trade, namely the exchanges within the group. Still less is it reasonable to attribute the European reluctance to do away with these restrictions to the wickedness and folly of governments and to the pressure of sectional interests rather than to considerations similar to those which make the strongest country in the world hesitate to expose its producers to foreign competition.

Assuming, however, that a single European market is capable of producing great improvements in European productivity which would be worth the
dislocation that would result from the reorganization of European industry, how is such a market to be established?

6.—The freeing of intra-European trade as a means of integrating the European economy.

Quantitative trade restrictions since the war.

The widely-held view that the removal of quantitative import restrictions and exchange controls in intra-European trade would automatically result in the creation of a single European market ignores the following facts about these restrictions:

A large part of the quantitative restrictions and exchange controls at present in force in European countries were introduced since the war, not in order to protect home industries, which under the conditions of inflation prevailing in the post-war period were doing a thriving business and required no additional protection, but in order to ensure that supplies needed for recovery would have priority over the importation of less essential goods. Without these restrictions the pace of European recovery would have been slower because the limited foreign exchange resources available to these countries would have been squandered on non-essentials. There can be no doubt that some local industries have profited from the lack of foreign competition and expanded their business, but there is no evidence that this has happened on any substantial scale, even less that it has altered significantly the structure of European industry. Taking as an example Britain, which had restricted more severely than any other European country the importation of non-essentials, we find that the bulk of the restrictions imposed resulted in the public doing without the foreign goods whose importation had been restricted, not in any significant expansion in the local production of similar goods. Even where there has been substitution, the substitution has usually been with less expensive products so that on balance the import restrictions have helped to reduce over-all consumption and release
resources for reconstruction. When, for instance, Britain restricted the importation of French wines and silks, the fact that people drank more beer and bought more British rayon goods did not mean that the restrictions served no useful purpose. Beer and rayon are less costly in terms of real resources than wines and silks and a real saving of resources resulted from not consuming the French products.

The fact that in countries where inflation was brought to an end and reconstruction completed the relaxation of trade restrictions did not result in any substantial increase in imports clearly indicates that these restrictions were not a protective device against foreign competition, but only a means of preventing internal weakness from creating too great a disequilibrium in external accounts.

It is also worth pointing out that any duplication of productive facilities which has taken place since the war has been due much more to the difficulty of obtaining supplies from other countries than to the imposition of quantitative restrictions by the importing countries. Thus, Britain and the Netherlands have been trying to expand their production of steel to replace types formerly imported from Belgium or France because they found that the supplies which they could obtain in these countries when they needed them most had declined sharply or could be obtained only at unreasonable prices. Similarly, the collapse of German production forced many countries to expand their production facilities for goods formerly obtained in Germany and allowed others to take advantage of Germany's disappearance to capture her former markets.

The fact that intra-European trade (excluding Germany) is at present at a higher level than before the war shows that the object of the quantitative restrictions at present in force is not to impede legitimate trade but mainly to prevent excessive imports and excessive deficits.

Our conclusion is that the restrictions and controls imposed on European
trade since the war have not been responsible for any fundamental changes in the structure of European industry and that consequently the elimination of these restrictions would merely result in a return to the pattern of production and trade which existed before the war, i.e., to a pattern which was far from anything that can be called a single European market.

**Intra-European exchanges before the Great Depression.**

The regime governing intra-European exchanges before the war may be described as follows: Before the Great Depression there were two groups of countries in Europe: free trade countries like Britain, Belgium, the Netherlands, Switzerland, and protectionist countries like Germany, France and Italy. The first group allowed virtually unrestricted sales of most foreign products in its markets. The second group maintained fairly high tariffs against imports of both agricultural and industrial commodities, but these tariffs, through the operation of the most-favored-nation clause, were uniformly applied to foreign goods without discrimination as to country of origin. Protectionist countries could sell their products in the markets of the free trade countries in competition with local products and with non-European, especially American, products. Free trade countries had only limited access to the markets of the protectionist countries, but whatever access they had was open under the same terms to the products of non-European countries. What prevented Europe from being a single market was not only that some countries imposed tariffs on European goods, but also that non-European countries had the same access to European markets as European countries themselves. Considering that American competition was, by that time, serious, it is probable that the absence of discrimination against non-European products was as important a factor as tariffs in denying to European producers the advantage of a larger European market for their products.

It would be interesting to try and visualize what would have happened to the European economy if an attempt had been made in 1928 to establish a single
market in Europe. Such a discussion would not be wholly academic, since it might help to determine the merits of a large European market protected by tariffs against outside competition as compared with world-wide competition in European trade.

The basic requirements for the establishment of a single market in Europe under the conditions obtaining in 1928 would have been the imposition of tariffs against non-European goods by the free trade countries, and the elimination by protectionist countries of their tariffs on European products while these tariffs were being maintained on non-European products. In theory each country could have applied its own tariffs to non-European goods, but in practice a unification of tariffs would have been required for the acceptance of the system by the countries with the higher tariffs since otherwise the freedom of trade within the region would have made the lowest tariffs the really effective ones. This is so because European importers would have used the freedom of exchanges within the region to obtain their overseas imports through the countries with the lowest tariffs. To attempt to prevent this through the imposition of restrictions on re-exports from European countries would have required irksome controls in intra-European trade and would have seriously interfered with the freedom of exchanges within a region in which entrepot trade and processing of imported raw materials for re-export represent an important part of total commercial transactions. Such controls would, moreover, have stimulated the establishment of industries in the countries with the lowest duties, not because these countries were necessarily best suited to produce the goods, but simply because advantage could be taken of the lower tariffs. To avoid all these complications it would have been necessary to adopt uniform tariffs against non-European goods, which would have required a considerable rise in the average level of tariffs against non-European goods in force before unification.
Would such a regime have led to a reorganization of European industry which would have increased its productivity? The producers of formerly free trade countries who had been subjected to American competition as well as European competition would have found that they no longer had to face American competition and could, therefore, in competition with other European producers, hope to capture the share of the European market previously enjoyed by Americans. In this case, there would have been substitution of more efficient by less efficient production and consequent loss to the consumer. The producers of protectionist countries would have had to face more European competition in their local market from the free trade as well as from the protectionist countries, but they would also have had a better chance to compete in the markets of other protectionist countries. The outcome would probably have been that the industries of free trade countries would have been able to sell more in Europe and those of protectionist countries less. This would have produced an expansion of industry in free trade countries and a contraction of industry in protectionist countries, which would have required a corresponding movement of capital and labor from the protectionist countries to the free trade countries. To the extent, however, that tariffs had previously been directed against American competition rather than European competition, the elimination of American competition might have produced an expansion of production in protectionist countries as well. It is, for instance, possible that the German tariff was primarily needed to protect German industry against American competition rather than the competition of British or French industries. In that case, the imposition of tariffs against non-European goods by formerly free trade countries and the elimination of tariffs on European imports by protectionist countries might have resulted in an expansion of opportunities for the German industry in the European market, while the elimination of German tariffs in intra-European trade might have had no serious effects on German industry.
How much would over-all productivity have increased as a result of these changes? Industries unable to compete with other European industries would have been eliminated and this would have been a gain for the region as a whole, but industries which formerly had to face American competition would have been able to raise their prices and exploit the consumer. The net effect of these two opposite tendencies would have been an increase or decrease in over-all European productivity, depending on whether the increase in intra-European competition would have reduced costs by more than the elimination of American competition would have increased them. Only events could have shown which of the two was more likely to happen, but there is a strong presumption for believing that no spectacular gains in productivity would have taken place. Similarly, the extent to which the market of individual industries would have been enlarged as a result of this new trade pattern and mass production methods would have become profitable would have depended on several factors about which there can be little precise knowledge.

The first factor is the nature and extent of European protectionism in the 1920's. If European tariffs protected only marginal producers, their elimination would have left the bulk of the industry unaffected and no drastic reorganization of European production would have occurred as a result of the removal of tariffs. If whole industries were depending on tariffs for their existence, the elimination of such tariffs would have produced a considerable redistribution of European industrial capacity.

The second factor is the importance of the European market for European industries. If European demand represented only a small proportion of the total demand for the output of an industry, even a very large expansion in European demand might have led to only a moderate increase in the total demand for the products of the industry. In that case, there would have been no
incentive to adopt mass production methods and no substantial reduction in costs of production would have resulted from the increase in European demand.\footnote{If we assume that a European industry, say the British shoe industry, had sold 50 per cent of its output in the British market, 30 per cent in non-European markets and 20 per cent in the European market, and that the elimination of European tariffs doubled the European demand for British shoes, this would have produced only a 20 per cent increase in total demand for the output of the industry and would not have justified a change in methods of production in that industry.}

The third factor is the extent to which the increase in intra-European exchanges would have affected non-European demand for European goods. As already stated, the creation of a single market in Europe would have required the imposition by free trade countries of tariffs on non-European goods. This would have produced a substitution of non-European with European goods, and would consequently have led to a decrease in imports from non-European countries. Since trade is a two-way affair, smaller European imports from overseas would in the end have meant smaller European exports overseas. Thus, the expansion in European demand would have been offset to some extent by the contraction in non-European demand.

It is clear that these factors would not have affected all European industries in the same way, but considering that there were no striking differences in industrial productivity in Western Europe, that the tariffs of most countries were moderate and that the trade of the most important countries in the group was oriented towards non-European regions, there is no reason to suppose that the establishment of a single market in Europe would have produced any spectacular increase in demand for the output of the major European industries, and consequently a revolution in methods of production.

Our conclusion is that under the conditions which prevailed in Europe before the Great Depression, the enlargement of the European market for the products of European industries would have been unlikely to result in any significant increase in European productivity. Americans, who attribute such a great
importance to the size of the internal market, will no doubt find this conclusion difficult to accept, but this is so only because they forget that by American standards European protectionism was mild, and European industries were already exposed to considerable competition. The truth is that the causes of Europe's relative economic decline lay elsewhere than in inefficiency produced by excessive protection of local markets in Europe. Switzerland was and remains a living reminder that a large internal market is not essential to a country's prosperity.

Intra-European exchanges during the 1930's.

Europe's liberal trade regime received a severe setback as a result of the Great Depression. The view is widely held that that Depression originated in the United States and that the trade restrictions adopted by the other countries in the 1930's were merely measures of self-defence against the dislocation in world trade produced by the American depression and by the sharp rise in American tariffs, which was the United States' immediate reaction to the depression. Whether one accepts this interpretation or not, the fact remains that the trade restrictions adopted in Europe during the 1930's were not a European, but a world-wide phenomenon produced by the inability of the leading industrial countries to solve the problem of unemployment and of insufficient effective demand for the world's products.

Trade restrictions were adopted by the major European countries with one main purpose in view: how to secure markets for domestic products and thus reduce unemployment. Each country felt that if it could discourage imports and at the same time induce or force other countries to buy its own products, its unemployment problem would be on the way to its solution. Different countries adopted different measures for achieving these ends, but the purpose behind these measures was in most cases the same. Thus, Britain had recourse to devaluation, tariffs, Imperial preference, bilateral trade agreements and the
abandonment of the open door policy in the Colonies. Germany, wishing to avoid devaluation, had to introduce strict exchange controls and relied more on bilateral trading and quotas than on tariffs to stimulate sales of domestic goods. France at first raised tariffs and introduced import quotas and finally resorted to devaluation. Other countries adopted different combinations of these measures.

The degree of restriction enforced by the various countries depended not on the kind of measures adopted but on their effect on foreign trade. The view, which is widely held in the United States, that tariffs or devaluation restrict trade less than quotas or exchange controls has no foundation in fact. On the contrary, since tariffs or devaluation are permanent measures and are considered as such by the industries affected, they are more likely to encourage the expansion of local industry at the expense of foreign industries than quotas and exchange controls, which are usually administrative measures subject to revision and abandonment and which few industries consider safe enough to justify an expansion in productive capacity. In other words, direct trade controls, whatever their other disadvantages, are less conducive than tariffs or competitive devaluation to the uneconomic expansion of productive facilities and are usually short-term measures adopted to deal with such temporary difficulties as unemployment, over-valuation of currency or balance of payments deficits rather than protectionist devices.

In the case of Europe, the differences in the type of restrictions introduced during the 1930's were a matter of circumstances or even of simple convenience rather than of differences in fundamental policies, and no special significance attaches to the choice of methods made by the various countries. This means that if one type of restriction, say quotas or exchange controls, had been removed in Europe while other types were maintained, the result would have been that countries which had relied on these direct measures would have found themselves at a disadvantage vis-a-vis countries which had adopted more general
methods of trade restriction, such as tariffs or devaluation. There can, for instance, be little doubt that an agreement to eliminate quotas and exchange controls in intra-European trade would have opened up the German market to British goods without at the same time restoring to Germany the markets she lost as a result of British devaluation, tariffs and imperial preference. The result would have been an unbalance in German trade which would have necessitated the reimposition of the restrictions removed.

It is clear from these considerations that a return to the pre-depression pattern of European trade would have required the elimination of all restrictive measures adopted since the depression and not merely of certain types of restrictions. And inversely, if it had been considered that certain types of restrictions were particularly obnoxious and should have been removed, it would have been necessary to replace them by other less objectionable but equally effective restrictions. What could not have been done was to remove certain types of restriction without replacing them with other types or removing those other types as well.

To what extent did the trade restrictions adopted during the 1930's affect the structure of the European economy and the level of European productivity?

As already stated, the trade restrictions of the 1930's were a universal and not a European phenomenon. Their effect on the world economy was to reduce international specialization and produce a less efficient use of world resources. The loss to the world economy from this less efficient use of resources was probably smaller than that resulting from the incomplete utilization of available human and material resources, the destruction of crops and the deliberate restriction of production which were characteristic of the world economy of the 1930's. This may explain why, in spite of the general recognition of the advantages of international specialization, so little was done during the
depression to revive world trade and why safeguarding employment remained the paramount consideration of economic policy in all countries throughout the 1930's.

The loss to the world economy from reduced international specialization was, however, real. If it were possible to make a quantitative estimate of that loss and of the effects of the various restrictions adopted, it would probably be found that three categories of restrictions had the most harmful effects from the point of view of world trade and world specialization. These were the following:

(a) American tariffs and American devaluation which, together with the depression, reduced the world's ability to sell and buy in the United States by some $2.5 billion per annum.

(b) Imperial preference, which diverted trade from more economic to less economic exchanges and reduced the scope of international competition.

(c) Tariffs and other restrictions imposed by primary producing countries against foreign manufactures which gave indiscriminate encouragement to industrialization in these regions and stimulated the growth of many inefficient industries.

These restrictions not only meant a less efficient use of available resources; they also produced a permanent change in the structure of the world economy.

As compared with this, the damage done by restrictions imposed on intra-European exchanges does not appear to have been great. No restrictions were, of course, imposed on intra-European exchanges as such, but the bulk of the restrictions imposed by each country in Western Europe on imports of manufactures were borne by other Western European countries, since these were the main countries exporting manufactured goods. As already stated, each Western European country sought to increase the demand for locally produced goods by discouraging imports of similar goods from abroad. In the process, exchanges
of manufactures among European countries shrank sharply. It may be estimated that in 1938 their value had declined by nearly half as compared with 1928, while the value of world trade had declined by 30 per cent. The results of this reduced exchange of manufactures may be assessed as follows:

There was a loss of consumer satisfaction. British consumers found that, say, French textiles, now subjected to tariffs, were no longer worth buying. French consumers found that, say, British bicycles, now subjected to import quotas, had become too expensive. In all countries consumers were urged by their Governments to buy national products, and to the extent that this was felt to be a duty, the loss of consumer satisfaction was probably tempered by the satisfaction of being patriotic.

There was also a less efficient utilization of available resources. The French, who had been more efficient than the British in producing certain goods, were no longer allowed to produce them, and the same happened to the British for other goods.

As each country sought to maintain employment in some industry, it created unemployment in a corresponding foreign industry, which in turn obtained protection against foreign competition, thereby reducing employment abroad. Thus, the restrictions adopted in the 1930's were not only conducive to a less efficient utilization of available resources, but also proved ineffective for the purpose for which they were adopted, namely, the maintenance of employment.

In our view, however, it is doubtful that these restrictions did much harm to the basic structure of European industry. It is more probable that the greater self-sufficiency sought by each country was achieved by the use of available resources and not by the creation of new productive capacity. Throughout the period new investments were on a limited scale, and there is no evidence that they were directed towards altering the structure of the European economy. Thus, Britain imposed a tariff on foreign textiles which cut down her purchases
of European textiles, but there was no corresponding expansion in British textile capacity, since the existing capacity was more than sufficient to take care of home and foreign demand. There was an expansion of industrial capacity in Germany along autarkic lines, but this reflected the war preparations of a dictatorship and not the effect of trade restrictions. The test of whether trade restrictions change the structure of an economy or not lies in whether their removal will create economic dislocation in the country concerned or not. Most of the restrictions imposed by European countries during the 1930's could have been removed without dislocation if a return of world prosperity had eliminated the need to safeguard home employment and protect local industries against cut-throat foreign competition. As a matter of fact, the recovery of 1937 and 1938 did produce a considerable relaxation of trade restrictions, and it is significant that in 1937 the British steel industry, which two years earlier had been clamoring for additional protection, was willing to see the duties on steel virtually abolished. This happened because rearmament and economic recovery produced an increase in the demand for steel which the British industry was not able to satisfy in spite of an expanded capacity. Such examples could be multiplied, and they indicate that in spite of the restrictions adopted during the 1930's, the structure of the European industry in 1938 was not far different from what it had been a decade earlier. Thus, these restrictions did produce, while they lasted, a less efficient use of available resources, but it is doubtful that they resulted in a considerably less efficient structure for the European industry as a whole.

The removal of quantitative restrictions in intra-European trade.

The preceding examination has shown two things: (a) that most of the quantitative trade restrictions introduced since the war were adopted for balance of payments rather than for protectionist purposes, which means that their removal depends on the solution of the balance of payments difficulties which necessitated their adoption, and (b) that the quantitative restrictions which existed before the war were one means among the many used to protect home industries and discourage imports, which means that their elimination depended on a relaxation of all trade restrictions, including tariffs and preferences.

It follows that the attack launched by EGA against quantitative trade restrictions as such is not justified and it is no wonder that the drive to eliminate quantitative restrictions in intra-European trade is meeting with so
little response in Europe. European countries are genuinely afraid that the removal of these restrictions may aggravate the already serious difficulties with which these countries are faced in trying to restore equilibrium in their external accounts. This is certain to happen in the following cases:

(a) When a country has not yet succeeded in bringing inflation under control. In that case, the removal of restrictions will inevitably lead to an excessive importation of foreign goods which will either result in a depletion of reserves or drive the country into debt. In other words, the removal of restrictions will make the country's external position still weaker than it was. It is sometimes argued that this would be salutary because it would force the country to tackle more vigorously its inflation problem. In our view, this is an extravagant and wasteful method of dealing with inflation, especially at a time when European countries are so short of reserves and foreign aid is barely sufficient to take care of their needs for essential imports from overseas. The only sensible thing to do in such a case is to tackle inflation first and then remove restrictions.

Not only inflation in itself, but also differences in degrees of inflation result in external disequilibria which may require the use of quantitative trade restrictions. In 1948, for instance, there was more inflation in France than in Britain, and as a result, France had a large sterling deficit. In 1949 the position was reversed: France disinflated her economy more than Britain, with the result that Britain had now a deficit with France. As compared with the United States, Europe as a whole must be considered as still suffering from inflationary pressure. This means that the liberalization of intra-European exchanges is likely to draw goods away from the dollar market and, therefore, increase Europe's dollar deficit.

(b) The removal of quantitative restrictions in intra-European trade may aggravate the external difficulties of countries like Great Britain which
before the war had a substantial deficit in their trade with other European countries. Britain, being less self-sufficient than most other European countries and having a higher standard of living, normally tends to spend more for European goods and travel than other European countries spend on British goods and services. Before the war Britain had a surplus of dollars in her overseas transactions, (mainly investment income and colonial trade), which she was able to devote to the settlement of her deficits with Europe. Since the war not only has the surplus disappeared, but a huge deficit with the dollar area has emerged which is kept within manageable proportions only through the strictest economy in dollar imports and large American aid. The most that can be hoped, at least in the next decade or so, is that Britain will be able to maintain her essential imports from North America after American aid is discontinued. It is wholly unrealistic to assume that she will ever again have dollars to spare on the many luxuries and relatively unessential goods she used to import from Europe before the war. This being so, a removal of British quantitative restrictions on intra-European payments may be ruled out as a practical possibility. The relaxation of these restrictions recently made under ECA pressure has already produced the increase in imports which was to be expected and may soon involve Britain in substantial deficits with Europe. It is easy to infer what the complete abandonment of these restrictions, coupled with the abandonment of bilateral trading requested by ECA, might mean for the British balance of payments.

(c) The removal of quantitative restrictions may produce serious difficulties in countries which had relied on such restrictions rather than on tariffs or devaluation to adjust their economies to the conditions of the 1930's. Germany, for instance, found that the devaluation of the British pound, the erection of tariffs in Britain and Imperial preference resulted in a sharp decline of German exports to the British Empire. It was clear that Germany had
to take measures to reduce correspondingly her imports from that area. Having rejected devaluation the Germans turned to bilateral trading and exchange controls as the main instrument of policy for conducting their commercial relations with foreign countries. A removal of all quantitative restrictions from German trade with Europe may reveal that European imports are too freely admitted in Germany as compared with German exports to Europe. The fact that the liberalization of imports recently undertaken by Western Germany in response to ECA wishes has immediately resulted in a substantial trade deficit with Europe in place of the large trade surplus of the last three years may not be unconnected with this feature of the German trade regime inherited from pre-war, namely the reliance on direct controls rather than general measures to maintain a balance in external accounts. Recent developments in Germany's trade with Europe are all the more striking as they occurred at a time of considerable deflation in Germany. It is not difficult to visualize how much greater the unbalance produced by the liberalization of imports would have been if higher levels of employment had obtained in the country.

Many of the restrictions imposed during the depression as a means of reserving the local market to local producers have lost their justification now that full employment and high levels of economic activity obtain in most European countries. Some of these restrictions have already been removed and many more can no doubt be removed. But there are others which must still be maintained and there are also restrictions which did not exist before the war and which post-war conditions have made absolutely necessary. The American view that quantitative restrictions are harmful as such, irrespective of the purpose they serve, is based on preconceived ideas rather than on facts. Our conclusion is that quantitative restrictions in intra-European trade cannot be swept away as a matter of principle, but only to the extent that the conditions which made them necessary have ceased to exist.
The removal of quantitative restrictions alone will not produce a single European market. Other conditions required.

Not only is the elimination of all quantitative restrictions in intra-European trade impractical, but it would also be wholly insufficient to produce the single market for Europe's goods which is the objective aimed at by those who demand the elimination of these restrictions.

In the first place, there can be no single market so long as tariffs protect local industries from outside competition. European tariffs, although not as high or restrictive as American tariffs, are high enough to afford such protection. Almost everywhere in Europe they are much higher than they were in the 1920's. If it were possible to compare the degree of protection afforded by tariffs and quantitative restrictions respectively, it is probable that tariffs would be found as important as, if not more important than, quantitative restrictions in determining the structure of European industry and agriculture.

It has already been pointed out that the reason for this is that tariffs afford more permanent and more specific protection than quantitative restrictions and are, therefore, a greater inducement to the establishment of local industries than measures which can be changed or withdrawn by mere administrative action.

The fact that if quantitative restrictions were removed exchanges between European countries would increase does not mean that the European economy would thereby be unified. It simply means that certain exchanges which could not previously take place are now allowed to take place. The creation of a single market within a region implies more than such an increase in exchanges in the region which may be brought about by increased economic activity and inflation as well as by the removal of quantitative restrictions. It implies the creation of equal opportunities for selling in that market which is not compatible with the maintenance of tariffs on the goods traded within the group.

Not only would tariffs have to be eliminated in intra-European trade,
but tariffs against non-European products would have to be unified and this, as already shown, would imply a rise in the average level of tariffs applicable to non-European products.

In the second place, a single European market is incompatible with the preferential tariffs and other special relationships of European countries with areas which do not form part of Europe.

At present Britain and France admit Empire products either free or at a lower duty than foreign products. If, as a result of European integration, European goods gain free access in the British and French markets, this will mean either loss of the advantage of preferential treatment granted to Empire products or actual discrimination against these products. Now Britain and France are themselves accorded preferential treatment in the markets of their overseas territories which they obviously will not retain if they cease granting such treatment to the products of these territories. It is, therefore, clear that if Britain and France are to become partners in a European economic union, they must abandon their special ties with overseas regions. These regions will either have to be treated as foreign countries or be incorporated in the union. To understand the significance of such a change, it is necessary to keep in mind that the promotion of trade within their Empires has been a major objective of policy in both Britain and France since 1930, and has assumed even greater importance in their post-war plans. The share of Empire countries in British and French trade increased as follows since 1928:

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th></th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1928</td>
<td>1938</td>
<td>1948</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>45</td>
<td>50</td>
<td>53</td>
</tr>
<tr>
<td>France</td>
<td>18</td>
<td>27</td>
<td>45</td>
</tr>
</tbody>
</table>

One may rightly feel that such a system of exclusive trading is a very inferior substitute for world-wide specialization and has resulted in the
creation of high-cost, high-price areas which are increasingly vulnerable to foreign competition. The fact, however, remains that this is a policy to which European countries have had recourse for the solution of their difficulties for the last twenty years and which they have been pursuing with even greater determination since the war.

Treating the overseas territories as part of the European union would subject the weaker of these territories to the competition of the whole of Europe and of other European possessions, while it would open up the markets of these territories, which are now reserved for the goods of the metropolitan areas, to the products of the whole of Europe. Thus, wheat and vegetable oils produced in North Africa would have to face the competition of wheat and oils from Australia and Indonesia, and inversely, French exports of sugar and textiles to North Africa would no longer be a virtual monopoly, but would have to face the competition of sugar from other European countries. Similarly, British manufactures would no longer be admitted in the Australian market on preferential terms, but would have to face German and French competition. It might be argued that these would be developments that would make for greater economic efficiency in the region as a whole, but this does not alter the fact that individual countries and areas would suffer losses and are not likely to be impressed by the argument that the region as a whole would be better off. Moreover, such a drastic change in trade patterns would require the acquiescence of the overseas countries themselves who do not belong to the European group, are not receiving American dollars and attach great value to their specialties with the metropolitan areas. These countries are unlikely to accede to their incorporation in a European union which would inevitably result in increased competition of European manufactures in their markets and consequent threat to the industries which they are trying to develop.

Treating the overseas territories as foreign countries in relation to
the European union would create even greater difficulties. The metropolitan areas would continue to treat favorably the products of their overseas associates, and since they would have abolished tariffs and other restrictions on European goods, they could hardly avoid doing the same on similar Empire goods. They would, however, retain their tariffs against imports from the overseas territories of their European partners. This would mean that the tariff regime applicable to overseas products would differ from country to country. But with free exchanges within Europe, importers would be able to obtain their imports from overseas through the countries which impose the lowest tariffs on these imports or admit them free of duty. Australian wheat would be freely imported in France through Britain and tobacco from the Dutch colonies would be freely imported in Britain through the Netherlands. Thus, the French tariff on foreign wheat and the British tariff on foreign tobacco would become inoperative. The only way to prevent this would be to impose controls on re-exports, which, as pointed out in an earlier section, would be so irksome as to defeat the object of liberalized intra-European trade.

Whatever might happen to the level of tariffs, it is clear that the creation of a single European market would automatically eliminate the preferential character of those tariffs. In other words, the mere fact of joining a European free market would involve the breaking up of the special ties which bind European countries with their overseas partners. This is one of the main reasons why Britain is so reluctant to go along with the idea of European integration and, whatever one may think of the exclusive arrangements which countries like France and Britain maintain with their overseas territories, it must be admitted that these arrangements form an integral part of the trade policies of these countries and cannot be easily given up for the sake of benefits which may take years to materialize and cannot be measured with any degree of precision.
But even if all tariffs were removed and preferential arrangements
with overseas territories eliminated, a whole range of devices would still be
available to European Governments if they wished to protect their nationals
against outside competition and prevent the redistribution of industry which
the creation of a single market was intended to bring about. Exemptions from
taxation, open or concealed subsidies, Government ownership or operation of
industries, currency manipulation, administrative practices and credit policies
could all be used to offset the effects of the removal of trade restrictions
and retain the basic features of the existing pattern of production. The
truth is that so long as Europe remains a region of distinct and independent
nations, agreement on trade policies alone cannot produce a single economy.
Genuine economic unification requires a common administration of taxes, expendi-
ditures, currency and credit, and a considerable unification of legal and
administrative practices. In other words, it requires the abdication by
national governments of their sovereignty in economic affairs and the establish-
ment of a central European authority to run the European economy. Nothing less
will equalize conditions to the extent needed to make Europe a single market
for the products of individual industries in the region. It is clear, however,
that Governments cannot surrender their economic functions to a central authori-
ty without surrendering the substance of their power. Thus, the surrender of
economic independence implies surrender of political independence as well.
Not only this, but without political unification economic unification may lead
to paralysing crises in the European economy if the greater economic interde-
pendence achieved increases the temptation, which is always there when inde-
dependent nations are dealing with each other, to use economic pressure in the
solution of political or economic disagreements. The current quarrel over
devaluation of two economically interdependent countries, India and Pakistan,
and the attempt made by each to paralyse the economy of the other is a
reminder of the kind of situation that may arise if Europe were economically unified, but remained a region of independent nations.

It is doubtful that those who propose the establishment of a single market in Europe realize the full implications of their proposals and what far-reaching and revolutionary changes in the life of European nations would be necessary if these proposals were to achieve the results aimed at, namely the creation of a single European economy. But even when the political implications of economic unification are recognized, it is felt that they add to rather than subtract from the merits of the case. If, it is argued, in the course of unifying their economies, European countries were to discover that they must unify their political life as well, this would be a gain for the cause of European peace and prosperity and a new source of strength for Europe. As already stated, one of the main attractions of the idea of integration lies in the promise which it holds, that economic integration may pave the way for political integration as well. The weakness of this approach is that it ignores the desires and wishes of the Europeans themselves. A movement for unity exists in Europe, but it is confined to a small minority of intellectuals and idealists. It is not far different from the movement for world government which exists in the United States. The vast majority of Europeans are as strongly attached to their national way of life and their independence as are the citizens of any other nation. Neighboring countries are as foreign to them as Mexicans or Canadians are to Americans. Nor are they impressed by the argument that they are too small and too weak to be able to afford the luxury of an independent national life. They feel that nationhood is connected with common traditions, language, and institutions, and has nothing to do with size of territory or population.

There are very strong arguments in favor of closer political partnership among Western European nations. These nations have enough in common to
form a regional group that would present a united front to the outside world, cooperate in the solution of common problems and avoid internal division and rivalries which have always been a source of weakness for the region as a whole. Whether they will in fact be willing to follow that course will depend on the extent to which they will find that the expected gains from closer political partnership will offset the loss of independence. It is, however, unlikely that the argument of higher productivity will influence the European attitude on this matter. Nations seldom sacrifice a cherished way of life for the sake of material benefits alone, even if such benefits are expected to be great. In the case of economic integration the benefits are at best distant ones, they are of unknown magnitude and they can be gained only at the cost of considerable immediate hardship. No wonder that the idea has found so little response in Europe. If European integration is ever to become a reality, stronger and more compelling arguments than higher productivity will have to be found.

Our conclusion is that the establishment of a single market in Europe requires much more than the removal of quantitative restrictions from intra-European exchanges. Considering how wide is the range of measures other than trade restrictions available to Governments for the purpose of influencing economic developments in their territories, it is probable that nothing short of political unity can produce the equalization of conditions of production and trade throughout Europe necessary for a unified economy.

7. The Cost of Economic Integration.

Apart from the difficulties of establishing a single European market, which are far more formidable than is recognized by the advocates of European integration, it is important to realize that a heavy price would have to be paid for such a drastic reorganization of the European economy.
Dislocation of European economy and greater need for American aid.

It must be accepted as axiomatic that the greater the benefits to be obtained from economic unification the greater the dislocation that would attend the efforts to produce such unification. This is so because an enlargement of markets will result in great increases in productivity only if new methods of production are adopted and a new structure of industry comes into being, i.e., if the European economy is reorganized on an entirely new basis. A mere increase in competition and the elimination of marginal producers cannot have decisive effects on productivity if the bulk of industry continues to be operated on the present scale and with the present equipment and methods of production. We must keep in mind that the chief argument of those who propose integration as a solution to Europe's difficulties is that it will enable the region to take advantage of the economies of large scale production and to adopt the mass production techniques which are believed to be responsible for America's high living standards. The view has been expressed in the American press that Europe could double its present income through the integration of its economy, and it is probable that a similar conviction lies behind the pressure exerted by ECA officials in favor of integration. It is clear, however, that such gains in productivity cannot be attained if the scale of industry remains virtually unchanged. Thus, large gains in productivity are synonymous with far-reaching changes in the European economic structure and will not result from a mere increase in competition among what are considered as uneconomic units of production.

1/ See The New York Times, February 19, 1950

"The people of Western Europe, if such an area were formed into one market, might be, in monetary terms, twice as well off as they are now. What stands in the way is inertia, old interests and jealousies and, in the case of Britain, a conflict, hard to resolve, between the interests of the sterling area and the common interests of Western Europe."
Let us try to visualize how the creation of a single market is likely to affect the various industries. We may take as an imaginary example the shoe industry and discuss its position in a single European market. There are two possibilities:

Either there are at present great discrepancies in productivity in the various national shoe industries with, say, the British industry possessing the greatest comparative advantage in production, or the level of productivity in most European shoe industries is approximately the same with, say, the French and Italian shoe industries including more inefficient firms than, say, the British or German. In the first case the creation of a single market in Europe will mean that the British shoe industry will now have a market of 300 million consumers for its products instead of the market of 60 million (50 million local consumers and 10 million foreign consumers) to which it was confined hitherto. This is the typical situation visualized by ECA officials. In the second case the creation of a single market in Europe will result in a contraction of demand for French and Italian shoes of, say, 30 per cent and an expansion of demand for British and German shoes of, say, 20 per cent. This is what we consider the most probable result of the creation of a single market. Such a change is not large enough to justify changes in methods of production, and no spectacular reduction in costs can result from the elimination of less efficient producers. The expectation of great increases in productivity is, therefore, predicated on the assumption that there are at present great discrepancies in productivity among the various European industries and that whole industries would be wiped out when exposed to the competition of other European countries. In our example, the shoe industry of Britain would prove so superior to those of other European countries that it would become the sole producer for the whole region. Faced with a five-fold increase in the demand for its products, it would find that it can now afford to install expensive labor-saving
machinery and introduce mass-production techniques which will reduce costs per unit of output. Meanwhile, the shoe industries of Continental Europe, unable to meet this British competition, would gradually contract until they are completely extinguished. Their plant and machinery would become obsolete and their workers would be left without jobs. And since the British industry would have adopted labor-saving techniques, the total labor needed to produce shoes would be less than hitherto. Shoes would now be produced and distributed more cheaply than before, but in order to do this it will have been necessary to make large new investments, abandon existing plant and machinery, much of which had only recently been repaired and renovated, and cause a net displacement of labor from the industry. In other words, the benefit to the consumers of cheaper shoes would not have been without cost.

In order to appreciate the extent of loss and dislocation involved it is necessary to visualize the process repeated in all branches of European industry and to realize that the changes that will take place will affect the various industries and the various countries differently, both from the point of view of the length of time required for the readjustment and from the point of view of the burden that will be imposed by the readjustment. Thus, the industries of some countries will be able to obtain the additional capital and labor required for their expansion more rapidly than those of others. This means that they will be able to put their competitors in other countries out of action and create unemployment in the industries of these other countries while the industries that will ultimately absorb the labor thus displaced, because of the length of time required to expand their capacity, are still unable to make use of the displaced workers. Similarly, there can be no guarantee that in each case the losses suffered by one country from the competition of other countries will be exactly balanced by the benefits which it will derive from the possibility of competing with these other countries in fields in which it possesses greater advantages. On the contrary, there is every likelihood that the weaker countries will find whole branches of their industries wiped out by competition with no equivalent expansion to absorb the redundant labor and provide alternative sources of income for the country. It is, for instance, probable that the Italian and to some extent the French industry may find that the branches
which suffer from British or German competition are more important to their economy than those which benefit from larger markets in Britain and Germany. In that case, there will be unemployment and a fall in wages and income which will make these countries a source of cheap labor for the region as a whole and might in their territories lead either to the establishment of labor-intensive industries or to a large-scale migration of labor or to both.

Eventually a new distribution of industry and population will emerge which may represent a more productive utilization of available resources for the region as a whole, but it will inevitably be preceded by a period of adjustment during which there will be great hardship for some and a loss of income for many. During that period there will be millions of unemployed that will have to be maintained by the community, there will be a shrinkage of purchasing power in the region that will affect the expanding industries themselves, while the movement of capital and labor will impose severe strains on the economies of both receiving and losing countries. The length of time that would be required for the completion of the process cannot be predicted, but it is clear that the amount of capital that will be available to finance this reorganization will be one of the decisive factors. If no new capital were available for investment, the creation of a single market would have no effect at all on the distribution of the European industry except in the cases where there was excess capacity which the removal of restrictions would enable to be utilized. In all other cases, all that would happen would be that goods formerly exported to non-European countries would be diverted to the European market by the greater ease of selling in that market. Thus, there would be a greater exchange of goods within Europe at the expense of exports to non-European regions, but there would be no increase in competition because there would be no expansion in the productive capacity of the more efficient industries. If, on the other hand, all the new capital necessary to reorganize the European industry on a
more productive basis became available overnight, the efficient industries would expand without delay and absorb the labor displaced from the less efficient industries. There would be no unemployment, no dislocation and the new pattern of European production would emerge simultaneously with the creation of a single market. These are obviously two equally unreal extremes, but they do indicate that the length of time required for the adjustment will be largely determined by the availability of capital. It is obviously impossible to estimate the amount of capital that would be necessary to finance the revolution in techniques which the advocates of European unity anticipate as a result of the establishment of a single European market, but it is well to remember that during the last four years Europeans have devoted some 20 per cent of their national income to the replacement and modernization of their productive equipment. The sums thus utilized may have amounted to $80 or even $100 billion. Now these large investments have done no more than repair the damage of war and improve the efficiency of existing industries. It is not difficult to imagine what the adoption of entirely new techniques in the whole field of industrial production would require. Whatever the actual amounts, they are bound to be multiples of these $80 to $100 billion already spent. If this is so, it is not possible to expect that the transformation of European production aimed at by the advocates of economic unification can be carried out in less than a decade.

During that period the European economy would be in a state of flux and uncertainty, with each country anxiously watching the rise and fall of industries and wondering what the outcome will be for its own economy. Many of the investments made during the last four years, often with the assistance and approval of ECA, would prove non-competitive and whole industries would go out of business. The need for American aid, far from becoming smaller, would be many times that of today and would be prolonged far beyond the period at present contemplated.
American aid is now supplying marginal quantities of food and raw materials to countries with a fully working economy. If these countries are to undertake a drastic reorganization of their economies, they will have to go through a period during which their output will decline, their export availabilities will be reduced and their need for capital goods will increase. Imports of American equipment, which until now have been relatively small and have represented only 9 percent of total ECA aid, would have to be obtained in infinitely larger quantities if mass production techniques are to become possible. To expect that the region itself can provide that equipment is to forget that Europe does not produce machinery for mass production.

The demand for integration made by ECA is not consistent with its assertion that American aid to Europe can be terminated in 1952. It suggests that the full implications of the steps urged on Europe have not been thought out or rather that the supporters of integration desire so passionately the end-result that they tend to brush aside any considerations that weaken their case. The fact, however, remains that the $5 billion or so that Europe is going to get in the next two years are totally inadequate to finance any drastic reorganization of the European economy. The argument advanced by ECA that, unless the process starts now while American aid is still forthcoming, it will never be started seems to miss the point. The question is: is present American aid sufficient to support the project? If not, the fact that without that aid the project would be still less practicable is not relevant to the argument. Even more unwarranted is the statement often made by the enthusiasts of integration, that unless Europe unifies its economy it cannot achieve independence from American aid. In fact, any serious attempt to integrate the European economy would prolong the European dependence on American aid well into the 1960's.

It is our conviction that such an attempt would mean another decade of economic uncertainty in Europe, serious unemployment with all its explosive
implications for the political stability of the region, and continued dependence on American aid with all the psychological dangers which such a pattern of relations between countries entails. In our view, it is not likely that the American Congress would retain very long its present enthusiasm for integration if presented with a sober assessment of the real cost involved. The cost is so high and the benefits so distant that even from a strictly economic point of view it is doubtful that the project would be worth undertaking. From every other point of view an attempt at European unification would create more problems than it would solve.

The danger of German domination of Europe.

It is impossible to know in advance what the economic structure of a unified Europe would be. It would depend not only on the relative competitive advantages of the various countries and industries, but also on factors such as political and financial stability, rates of exchange, and so on, which are not susceptible of measurement and defy prognostication. It is, however, safe to assume that Germany's position in a unified Europe would be a preponderant one. The huge concentration of skills, mineral wealth and industrial capacity in Western Europe are likely to make that country the center of European heavy industry. It is doubtful that the heavy industries painfully built up by Germany's weaker neighbors would have much chance of survival if left at the mercy of German competition. No European country can contemplate such a prospect with equanimity and one can only wonder whether any gains in productivity, however great, can offset the risks to world peace involved in allowing Germany to acquire such a strategic position in the European economy. To assume that Germany would not misuse her power is to ignore completely the lessons of two wars. To hope that such a concentration of economic power in Germany could be made safe through the "internationalization" or control of the German heavy industry is to possess a faith in formal agreements which experience to date does not justify.
European integration, if it were attempted, might well prove Germany's new opportunity to attain the political domination of Europe which has been the aim of German policy ever since the modern German state came into being. The eagerness with which the Western German Government has responded to the American plea for European integration testifies to the shrewdness of German statesmanship, but can only arouse misgivings in other European countries. For that reason alone the European attitude to integration was bound to be cautious and hesitant.

The creation of permanent discrimination in world trade.

At present severe restrictions are in force in most European countries against imports from overseas regions. The purpose of the restrictions is to limit expenditure in foreign exchange to the minimum compatible with the working of European economies and ensure that essential commodities get priority over less essential goods. The restrictions limit either the amounts or the types of goods that can be imported or both. Thus, coffee, meat, fats are imported in quantities estimated to be essential to the economy of the country concerned but cannot be imported beyond those quantities. American manufactures, other than machinery, are virtually prohibited from entering European markets.

The degree of severity of these restrictions as well as of their administration varies from country to country according to the acuteness of its foreign exchange position. Switzerland, which has no dollar problem, follows a liberal import policy. Belgium, whose dollar position is more favorable than that of other European countries, admits many American goods that are not allowed to enter other European markets. The United Kingdom, whose dollar position is extremely critical, enforces the strictest economy in its purchases from overseas, especially from the dollar area.

As compared with the severity of the restrictions applying to overseas trade, trade within Europe is on a rather liberal basis. Fruits, canned foods,
cheeses, whose importation from the dollar area is virtually prohibited in Britain, are freely imported from Italy and other European countries. Imports of textiles, cars, miscellaneous consumer goods are admitted without too great difficulty in European markets when originating in other European countries, but are strictly regulated when coming from the dollar area. Allowances for travel are liberal when the expenditure is to be made in Europe, and strictly limited when travel to other areas is involved. Europe's inflationary situation makes sure that there is no lack of purchasing power to absorb the goods and services which are thus allowed to flow within the region, and this explains why selling in Europe and other soft-currency areas is a more attractive proposition for European producers than selling in the competitive dollar area.

The fact that the volume of intra-European exchanges, excluding exchanges with Germany, is considerably larger than before the war, while the imports of the major European countries from the United States and from other hard-currency areas, in spite of the large American assistance received, are barely at pre-war levels shows that trade restrictions bear much more heavily on exchanges with the outside world than on intra-European exchanges.

The ECA demand for measures that would further liberalize intra-European trade but would do nothing to produce an expansion in trade with overseas regions would only perpetuate the present dualism in Europe's commercial transactions and make discrimination against non-European goods a permanent feature of Europe's trade regime.

The reorganization of European industry that would result from the creation of a single market in Europe would take place under the protection of present restrictions against non-European goods. This means that the new industries, even if more efficient than the old ones, might still be non-competitive with American industries. To expect that the creation of a single market in Europe would automatically make all European industries competitive with
American industries is to attribute to the size of the market as a factor in productivity an importance which it can hardly possess. As already shown, the theory that the size of the American market is the principal cause of America's high productivity is, at best, an unproven dogma and is too flimsy a foundation for rebuilding the economy of a whole region. But even if the increases in productivity that might result from European integration could make European industry as a whole more competitive with American industry than it is now, it does not follow that all industries that would be expanded under the protection of present restrictions would be equally able to compete with their American counterparts. A subsequent removal of these restrictions would inevitably expose some, at least, of these European industries to a degree of competition for which they had not been prepared and which they may prove unable to withstand. The theory that liberalization of intra-European exchanges would pave the way towards a liberalization of world exchanges ignores the fact that each trade regime creates its own conditions in the field of production and that moving from one trade regime to another requires corresponding changes in the structure of production. As already stated, the removal of restrictions in intra-European trade would strengthen certain industries and weaken others. The industries strengthened may be superior to other European industries, but they may still be inferior to non-European industries. A subsequent removal of restrictions on imports from non-European countries may well show that the expanded industries would have to contract again when faced with non-European competition. Since it is unthinkable that European countries would be willing to expose their industries to the continuous shocks of new trade conditions, it is more probable that the trade restrictions originally in force against non-European goods would have to be permanently maintained to protect the new structure of European industry.

It has been argued that discrimination against non-European goods is a
fact of the present European trade situation and would not become worse if intra-European trade were still further liberalized. This is not correct, since greater freedom in intra-European exchanges means greater discrimination against non-European goods and a further reorientation of European trade away from overseas markets. Furthermore, discrimination is at present considered as a necessary evil from which it is the declared policy of the major trading countries to get away as soon as possible. To rebuild the European economy on the basis of that regime not only means that discrimination will become permanent, it also implies the abandonment of the objectives of freer world trade and general convertibility of currencies. To those who do not believe in these objectives the loss may not appear great, but this can hardly apply to Americans who have made the attainment of freedom in international transactions one of the chief aims of their foreign economic policy.

Apart, however, from the fact that the American demand for European integration is inconsistent with the other aims of American economic policy, it also reveals a lack of faith in the possibility of expanding European trade with the outside world and especially with the United States, which the American willingness to recognize the need for larger American imports does not seem to justify. It may take several decades to achieve a substantial liberalization of American import policies, but the trend is there and it should be encouraged. To push European countries to establish an economic structure which assumes that the dollar shortage and the attendant discrimination against American goods will be with us for as far ahead as we care to look is not the best way to ensure an expansion of trade between the dollar and non-dollar world.

There could have been some justification for seeking to turn Europe into an exclusive trading area if this would have meant greater self-sufficiency for the region as a whole and smaller dependence on outside supplies. In that case the loss from reduced international specialization would have been offset by the
greater stability and greater security which a smaller dependence on world trade entails. Western Europe, however, cannot increase its self-sufficiency by integrating its economy because of its dependence on outside sources of supplies for food and raw materials which cannot be produced in sufficient quantities in the region itself. The project of European integration might have made some sense if Eastern Europe had been included in the project and its primary production expanded to satisfy the needs of the industrial countries. As it is, the prosperity of Western Europe and the standard of living of its population depend on its ability to obtain from abroad ample quantities of primary products. It is exactly because changed world conditions have impaired this ability that Europe is experiencing its present difficulties and has become dependent on American aid. The answer to this problem is not to create an exclusive trading area within Europe, but to stimulate exchanges with the outside world that will enable the region to secure the supplies on which its whole economy depends. How vital these supplies are can be seen from the fact that while they represent less than 10 per cent of the total income of the region, any reduction in the quantities available threatens the whole region with economic collapse. The distinction between "essentials" and "non-essentials" made by European countries is a very real one, and their reluctance to utilize scarce resources for the purchase of less essential supplies from other European countries is based on a common-sense view of their real needs.

A high volume of exchanges with countries which produce the primary products essential to the European economy is a prerequisite for European prosperity and must be the chief aim of European policy. To seek the solution of the European problem in higher intra-European exchanges, which for countries like Britain are least important for their economies, is to place the wrong emphasis on the European problem. To try and subject to a special regime one part of the exchanges of a region which maintains close and complex economic relations
with the whole world is to invite all kinds of new difficulties in the region's external transactions. In an earlier section we have shown what anomalies would arise in European trade if the creation of a single European market were not accompanied by a unification of European tariffs. The fact that quantitative restrictions and controls in force against non-European goods vary greatly from country to country would create a similar problem. Countries which would admit more freely than others dollar goods might become a source of indirect dollar imports for these other countries. (This actually happened in 1947 when Belgium found that many of its dollar imports were being re-exported to other European countries against soft-currencies.) In that case, they would either have to control their exports to the other European countries or tighten up their restrictions against dollar imports. Thus, countries which could afford liberal trade policies would be forced by the special arrangements applying to intra-European exchanges to maintain restrictions which they did not need. This would be a distinctly retrograde step in the efforts to free world trade. In short, tinkering with intra-European exchanges instead of seeking an international solution to the problem of trade restrictions is likely to do more harm than good to all concerned, and it is certainly not the way to restore freedom in international transactions.

Our conclusion is that an attempt to establish a single market in Europe, if seriously made, would dislocate the European economy for at least a decade, it would entail the danger of German domination of Europe and it would create a permanent discrimination in world trade. This would be a truly prohibitive cost and, in our view, no gains in productivity that would result from integration can be great enough to offset it.
8.- Increased competition in intra-European trade and the proposals for a European Payments Union.

"Integration" in the limited sense of freer exchanges within Europe.

We have so far discussed European integration in the sense of a complete unification of the European economy. This is the only definition of integration which is consistent with the claims made on its behalf, namely, that it would lead to the establishment of a mass market in Europe, the adoption of mass production techniques and the emergence of large-scale industry. As already shown, such revolutionary changes in the economic structure of Europe, assuming that they are at all possible, would require the attainment of a high degree of economic, financial and even political unification and cannot result from a mere relaxation or even abolition of direct trade restrictions and controls within the region.

Many supporters of integration are, however, thinking in more modest terms when they refer to the need of "integrating" the European economy. All they have in mind is increased competition among European industries which, by eliminating inefficient producers, would raise European productivity. They feel that a relaxation of trade restrictions would help to accomplish this and is, therefore, a step which European countries should take in the interests of their recovery.

The contention that increased competition would benefit Europe is correct as far as it goes and so is the contention that a relaxation of trade restrictions would promote such competition. The problem, however, is far more complex than the supporters of "integration" in this limited sense seem to think, while many of the conclusions which they draw from these two premises are not warranted by facts.

In the first place, it is important to keep in mind that the gains in productivity that would result from increased competition among European industries are not likely to be great and can make no significant contribution to the solution of Europe's major economic problem, namely, its difficulty in paying for
its essential imports of primary products from overseas regions. We have already explained why we consider that the most likely result of such increased competition would be to eliminate marginal producers but leave the bulk of European industry unaffected, and have pointed out that if the European industry continues to produce with its present methods and on the present scale, there can be no spectacular changes in the levels of its productivity. In our view, it is wholly inconsistent to say that integration means only increased competition among industries that would continue to function with their present machinery and their present techniques, and at the same time maintain that such integration would result in great gains in productivity. If it is true that integration in the limited sense of liberalization of intra-European exchanges will not produce a mass market in Europe nor a revolution in European methods of production, then there is no justification for claiming that it would be attended by spectacular increases in output that would provide the answer to Europe's present economic difficulties.

In the second place, there is not even a certainty that a liberalization of intra-European trade would lead to increased competition among European industries. The typical European business man is notoriously averse to competition and is an adept in monopolistic practices. Before the war cartels and trade associations with their price-fixing arrangements, marketing quotas, and so on, dominated the European industry,¹ and there can be little doubt that the framework within which such arrangements could be revived has been preserved intact. It is not sufficient to create conditions under which competition is possible, there must also be the will to compete which may prove absent in many European industries.

¹ The Report on International Trade prepared by Political and Economic Planning, London, 1937, p. 102-124, gives a long list of commodities, by no means exhaustive, on which cartel arrangements existed in 1937. It concludes that "the extent to which international control of trade and production has developed is very remarkable and covers, in one way or another, an important proportion of the trade of the world."
In the third place, it is necessary to remember that all restrictions at present in force in intra-European trade are not intended to prevent competition and that many of them serve a useful purpose in helping to maintain equilibrium in intra-European exchanges. It is probably no exaggeration to say that a very large, and in some cases an overwhelming, proportion of the restrictions and controls at present applied in intra-European exchanges serve balance of payments rather than protectionist purposes. The task of protecting home industries against outside competition is entrusted to tariffs rather than quantitative restrictions and controls, and it is significant that countries, like France, which during the post-war period of scarcity and inadequate home production had abolished tariffs on many goods, are now busy restoring them in response to demands for protection from their producers.\(^1\)

The persistence of inflationary pressures in some countries makes the maintenance of import restrictions by these countries necessary to prevent deficits in their external accounts. Similarly, countries like Britain and the Netherlands, which normally tend to spend more in other European countries than they earn from them, must either maintain restrictions in their relations with other European countries or settle their deficits in dollars which they no longer have. Under these conditions, decreeing that all quantitative restrictions on intra-European payments must be swept away might result in the creation of an unbalanced position in intra-European payments which would absorb dollars urgently needed elsewhere and burden the deficit countries with large intra-European debts.

In the fourth place, all trade restrictions and not merely those applying to intra-European trade limit competition and protect inefficiency. The aim should be to lower trade barriers all over the world and encourage international specialization. Intra-European exchanges are only a segment of world trade and action

---

\(^1\) The Foreign Commerce Weekly of February 20, 1950, p. 19, summarizes the latest extensive lists of products on which import duties were restored in December 1949.
confined to them will not go far in promoting a more efficient use of world resources. Moreover, freeing of intra-European exchanges while the present severe restrictions are maintained on transactions with other regions would induce changes in the European economic structure that would make it extremely difficult at a later stage to relax restrictions on exchanges with non-European regions. It would, therefore, lead to a permanent discrimination in world trade.

In short, it must be recognized (a) that the contribution which a liberalization of intra-European exchanges could make to the solution of Europe's difficulties is likely to be limited, and (b) that the indiscriminate removal of all restrictions qua restrictions is neither possible nor desirable. Provided this is recognized, there is everything to be said for exploring the possibility of removing unnecessary obstacles to the flow of goods and services within Europe. Nor should it be assumed that European countries are not aware of this. The recent freeing of virtually all transactions, including some capital transactions, between Switzerland and Belgium shows that whenever the existing conditions make this possible many European countries are quick to do away with unnecessary restrictions.

Our conclusion is that action to liberalize intra-European trade should be cautious and selective, and should not divert attention from the far more important task of liberalizing world trade.

Intra-European exchanges since the end of the war.

In our view, the recent ECA proposals for the establishment of a European Payments Union do not meet the above criteria, and this is why we consider their acceptance in their present form as highly improbable. Before discussing these proposals, it would be useful to summarize developments in intra-European payments since the end of the war. We may distinguish two phases in these developments.

Until the end of 1947 intra-European exchanges had been the sole concern of individual European countries and had been regulated through bilateral clearing
or payments agreements. No serious difficulties had arisen in financing these exchanges, as European countries had extended large credits to each other and had been willing to settle balances in excess of credit margins through gold or dollar payments. With the exhaustion of credits and the depletion of reserves which became apparent by the end of 1947, concern began to be felt lest the difficulties of settling balances among European countries lead to a contraction of intra-European trade at a time when the emphasis was on mutual self-help and closer European cooperation. In 1947 Belgium had emerged as a major creditor vis-à-vis most other European countries. Her payments surplus with the group as a whole, which had been estimated at nearly $400 million, was financed through credits extended to other countries and gold and dollar payments made by them. Many of Belgium's exports consisted of such essential supplies as metals, steel, machinery, which were hard to obtain elsewhere and on which countries like the Netherlands were absolutely dependent for their recovery. It was felt that something had to be done to maintain such a flow of supplies in Europe. Similarly, since the end of the war France had been short of sterling for the purchase of essential materials in the sterling area. British credits and the liquidation of sterling securities had carried her through until then, but these had been exhausted and new means were required to keep France adequately supplied with sterling. Finally, Western Germany was at that time virtually a part of the dollar area, and the other European countries were required to pay in dollars for their imports of German coal. As dollar reserves were being depleted, the problem of financing these essential purchases from Germany assumed serious proportions.

Already in September 1947 the Paris Conference on European Economic Cooperation had pointed out that American dollars might be necessary to prevent a contraction in intra-European exchanges. At first the idea did not appeal to Americans, who felt that the object of American aid to Europe should be to help European countries obtain essential commodities in the Western Hemisphere for
which they were not as yet able to pay and not to provide an easy solution to all
the difficulties facing Europe. By the summer of 1948, however, payments diffi-
culties in the critical areas referred to above had increased sufficiently to alter
the American attitude on this matter. A temporary $300 million allocation for off-
shore purchases in Europe was made and European countries were enjoined to negotiate
among themselves a Payments Scheme that would provide a satisfactory basis for
carrying out intra-European exchanges. It was understood that the use of ECA
dollars for the settlement of intra-European balances would be an essential part
of the scheme.

Thus came into existence the first Intra-European Payments Agreement signed
in October 1948, which marks the beginning of the second phase in the history of
intra-European exchanges, characterized by the utilization of American dollars for
the settlement of intra-European balances. In its essentials the scheme provided
that certain countries would extend grants (called drawing rights) to other coun-
tries as a condition for receiving equivalent amounts of dollar aid from ECA. The
main grantors were Belgium and the United Kingdom and the main recipients the
Netherlands, France, Greece and Austria. The total of the grants extended
amounted to some $800 million, corresponding to an average of some $90 million
per month for the period covered by the Agreement (October 1948-June 1949). These
grants were strictly bilateral in character and were based on forecasts made in the
autumn of 1948 of balance of payments positions between pairs of countries within
the group for the period of the Agreement. The bilateral character of the grants
came under criticism from many participating countries, and efforts were made dur-
ing the negotiations for a new Agreement in the spring of 1949 to achieve the
multilateralization of these grants. Britain, however, fearing an undue concen-
tration of sterling in the hands of Belgium, which would involve her in dollar pay-
ments, refused to accede to this demand, and a compromise was reached whereby only
a proportion of the grants (25 per cent) would be transferable within the group.
The new Agreement covering the period July 1949-June 1950 provided again for $800 million drawing rights, corresponding to $67 million monthly. The main net recipients were again expected to be France, the Netherlands, Greece and Austria. Belgium was again to make the largest net grants, amounting to $312.5 million, but Western Germany was also to be an important creditor with a net contribution of $110 million, while the net contribution of the United Kingdom was to be reduced to $96 million as compared with $252 million in 1948-49.

The desire to reduce the bilateral character of intra-European payments led to arrangements for limited multilateral compensation of balances to be carried out monthly through the Bank of International Settlements. Great expectations had been placed on these arrangements, and the hope had been expressed that a major obstacle to the exchange of goods within Europe would thereby be removed. The results proved disappointing. During the nine months of the first Payments Scheme compensations amounted to only $35 million, indicating that while the unbalance resulting from net creditor-debtor positions persisted, the scope for multilateralization was bound to remain limited.

What was the significance of all these arrangements for the development of intra-European trade? During 1947 total intra-European trade amounted to $5,800 million, and of these probably some $400 to $500 million represented net unbalanced positions which required credits or dollars for their settlement. In 1948 total intra-European trade had increased to some $7,500 million. Net positions have not been calculated, but they may have amounted to some $600 million. This growth of trade between 1947 and 1948 represented a growth in production and supplies rather than an increase in outside financing, and was, therefore, a development in the right direction. In 1949 intra-European trade expanded again, to $9 billion or $750 million monthly, reflecting further increases in European production and greater availability of supplies. As against this total, the $90 million of monthly drawing rights for October-June and $67 million for July-June 1950 represented approximately the same degree of unbalance requiring outside

1/ Belgium agreed to grant (a) $200 million in bilateral drawing rights; (b) $112.5 million in multilateral drawing rights, both against ECA conditional aid; (c) $87.5 million in long-term loans, linked with the multilateral drawing rights.
financing which had prevailed during the previous two years. Thus, the intra-European Payments Scheme, while financing less than 10 per cent of the total intra-European trade and, therefore, not affecting significantly its volume, was devised to maintain the pattern of trade which had prevailed since the end of the war, and which consisted in large net surpluses for Belgium, the United Kingdom and Western Germany and large net deficits for the Netherlands, France, Greece and Austria. Events in 1949, however, proved more powerful than the Payments Scheme in determining the pattern of intra-European exchanges. These events falsified many of the predictions on which the allocations made in the Agreement had been based. Britain's position in intra-European payments weakened markedly. At the end of June 1949 only $226 million of the $312 million of drawing rights granted by Britain to other countries had been utilized, while Britain herself had to make gold payments totalling $125 million (in excess of her drawing rights) to Belgium, Switzerland and Western Germany. On the other hand France, Italy and Western Germany failed to use drawing rights equivalent to $128.5 million. Even the countries which utilized fully their allocations complained that they had been compelled to buy many goods which they did not need. Thus, the Report of the ECA Mission to Greece, (February 1949, p. 44), notes that "experience indicates a marked reluctance on the part of participating countries to exchange essential products for Greek exports and net drawing rights." This, the Report points out, in spite of the fact that "Greece was awarded large net drawing rights instead of direct dollar aid on the insistence of other participating countries that they could supply the goods needed by Greece." The divergence between allocations and realized positions increased still further in the second half of 1949. Britain's position deteriorated sharply during the three months preceding devaluation, showing a net deficit of $420 million, and recovered equally sharply after devaluation, showing a net surplus of $142 million for September 18 to December 1950. France, which had been the chief debtor country during the first Payments
Agreement and had been expected to require net drawing rights of $210 million for 1949-50, suddenly developed into a net creditor country with a net surplus of $145 million during July-December 1949. Western Germany, which had been a net creditor ever since her reappearance in European trade and was expected to grant net drawing rights totalling $110 million in 1949-50, suddenly developed a huge deficit of $110 million (September-December 1949). The Netherlands, expected to run a net deficit of $8 million per month in 1949-50, developed a monthly surplus of $5 million in September-December 1949. Finally, for the first time since the war Belgium became a net debtor during September-December 1949. Multilateral compensations, which had been reduced to a mere $3 million monthly during July-September 1949, increased to $10 million in October and $30 million in November, indicating greater opportunities for settling balances within the region and smaller dependence on outside financing. (In December, however, compensations fell again to only $4.5 million). This complete reversal of positions in the last part of 1949 was due to the following factors: (a) the stabilization of France's internal finances and resulting strengthening of her external position; (b) the deterioration of Britain's external position prior to devaluation and its subsequent improvement following devaluation; (c) the removal of import restrictions by Western Germany in the autumn of 1949, which produced an avalanche of imports of foodstuffs and other consumer goods from neighboring countries, especially the Netherlands; (d) the new exchange parities favoring the British pound and the French franc at the expense of the Belgian and Swiss francs and of the Italian lira. There is no way of telling whether these developments represent a new pattern in intra-European payments or are merely a transitional phenomenon, but they do demonstrate the futility of trying to estimate in advance surpluses and deficits as though they were given magnitudes and not the result of the interaction of a great number of factors operating over a period of time in different directions and with differing degrees of intensity.
The ECA proposals for a European Payments Union.

It was the realization that the Payments Scheme no longer fitted the facts which led to the demand for its revision and brought forward the ECA proposal for a European Payments Union. The recognition of the inadequacy of the Scheme coincided with the renewed pressure of ECA for evidence that European countries were proceeding with the integration of their economies. This circumstance led to a reconsideration of the whole problem of intra-European exchanges in the wider context of the American desire for closer economic relations among European countries.

From the beginning of its operations ECA has tended to consider a high volume of intra-European exchanges as particularly important to European recovery and as evidence of closer European cooperation. Until recently, however, the emphasis was on assisting the flow of essential supplies to countries which were still unable to pay for them in suitable currencies, and this was the main justification for allowing the injection of ECA dollars into the European trade circuit. The recovery of European production and the great expansion in European exports achieved during the last year have removed this consideration from the foreground of intra-European payments problems. At the same time the difficulty of eliciting from European countries any concrete action on integration other than declarations of a desire to cooperate has suggested to ECA officials that the Payments Agreement was the only field in which European countries could be forced to take practical steps for bringing their economies closer together. The fact that they depended on ECA dollars to make the Agreement work reinforced the feeling of ECA that here was the field in which pressure could be exercised and efforts be made to achieve progress towards the aim of integration. As already stated, all this coincided with the striking changes in the relative positions of the various countries which followed devaluation and which upset most of the calculations on which the Agreement has been based. New and better arrangements thus became imperative,
and ECA seized the opportunity thus offered to incorporate in its proposals for such arrangements aims which far transcend the original purpose of the Payments Agreements. These aims are: (a) a considerable liberalization of intra-European exchanges through the removal of all quantitative restrictions in intra-European trade and payments and the abandonment of bilateral trade; (b) complete transferability of European currencies so that for internal European purposes one currency be as good and as desirable as any other; (c) eventual convertibility of European currencies into dollars through arrangements whereby an increased proportion of net debits arising in intra-European exchanges must be settled in dollars.

The main features of the ECA proposals for the establishment of a European Payments Union, in which these aims are incorporated, may be summarized as follows:

(i) Elimination of all bilateral trade restrictions upon the coming into effect of the Union, rapid reduction of all multilateral quantitative restrictions in the course of 1950 and their substantial elimination by the end of 1950.

(ii) Progressive reduction of other restrictions on current account and placing of all such restrictions on a multilateral basis.

(iii) Full intra-European currency transferability for current account transactions, with the liberalization of capital transactions to be left to the initiative of the various participating countries.

(iv) Establishment of a clearing union among participating countries with a common unit of account for reckoning surplus and deficit positions and making settlements. Each member should have a quota related to the total volume of its current transactions with the group as a whole, which would serve as a basis for determining its claims and obligations towards the Union. A percentage of this quota (to be determined) would represent a credit margin for normal payments swings and surpluses or deficits falling within this percentage would not require settlement. Beyond that percentage countries would have to settle their
balances through credits and gold or dollar payments. Thus, a country accumulating a deficit greater than its normal credit margin would have to settle part of the difference in gold or dollars and for the remaining part would have to undertake the obligation to repay the Union within a specified period. As the country's deficits towards the Union increase, the proportion required to be settled in gold and dollars would progressively increase and the proportion covered by repayable credits would decrease. Inversely, a country accumulating a surplus greater than the normal credit margin would receive gold or dollars for part of the difference and would have to extend credits to the Union for the remaining of the difference. As its surpluses increase, the proportion of the increase which is payable in gold or dollars would progressively decrease and the proportion for which credits must be extended would increase. In this way both creditors and debtors would be discouraged from allowing large balances to accumulate in their favor or at their expense.

(v) ECA dollars would be made available to the Union for the following two purposes: (a) to cover structural surpluses or deficits, i.e., surpluses or deficits which are considered as part of the normal European trade pattern; (b) to cover the expected difference between obligations to settle deficits in dollars and claims for dollars to settle surpluses achieved within the system. (These two magnitudes would not coincide, since they would be calculated on a different basis for creditor and debtor countries.) The amounts of ECA dollars to be thus injected in the system would be determined by ECA itself, while the allocations of dollars for structural deficits and surpluses would presumably be made jointly by the ECA and the Union. At the end of the period of American aid any net balances which are not covered by credits would have to be settled by gold or dollars to be provided by the debtor countries themselves.

(vi) Countries whose position proves to be persistently unbalanced within the system would be required to take remedial action. Two types of remedial
action are contemplated by the proposals: (a) modification of internal economic policies and (b) exchange rate adjustments. Restrictions on current payments would be allowed only while the above corrective measures are taking effect and they should be multilaterally applied. A country which needs such restrictions for longer periods would be expected to withdraw from the Union, at least temporarily.

These ECA proposals raise the following questions:

(a) **Liberalization of intra-European trade.**

As already stated, an indiscriminate removal of all quantitative restrictions in intra-European exchanges might produce a serious unbalance in the position of some countries. Similarly, the abandonment of bilateral trading, although highly desirable in theory, might in practice so greatly weaken the external position of certain countries as to create considerable disturbances in intra-European exchanges. Britain, for instance, has been carrying on her trade with Denmark on a bilateral basis since the early thirties. It is not possible to predict what would happen if these arrangements were abandoned, but there is a strong presumption for suspecting that while Denmark would still be selling the bulk of her exports to Britain, she might find it more profitable to use her sterling for the purchase of Belgian or German goods. If this happens, Britain might become a debtor to the system and have to pay dollars for her imports of food from Denmark. Finding that she cannot afford this, she might have to impose multilateral restrictions on all imports of food including those from, say, the Netherlands, for which she has no difficulty in paying. Or rather, according to the ECA proposals, she would have to produce a deflation in her economy in order that people may not have the money to buy Danish food, unless she were prepared to devalue again her currency and thus make her exports cheaper and her imports more expensive. The question is: would this be an improvement, as far as European exchanges are concerned, over present arrangements? Would European
countries prefer the removal of restrictions to the maintenance of their present volume of exchanges? The answer is obviously negative.

Again, for a year or so Britain would have been spending dollars and accumulating a debt vis-a-vis Europe simply in order to find out that without her bilateral arrangements she would not be able to import as much food from Europe as she had been importing. It is difficult to imagine a more wasteful utilization of scarce dollars.

It has been argued that, unless the experiment in free intra-European trade were made while ECA dollars are available to finance it, it will never be made and European trade will continue to be constricted into bilateral patterns. This assumes that ECA dollars can be spared for experiments, which hardly seems to be the case. It also assumes that there is something particularly obnoxious in bilateral trading within Western Europe, since no similar efforts are suggested for trying to liberalize Western European trade with Latin America, Eastern Europe and Asia, which is at present overwhelmingly carried out through bilateral trade deals.

It has also been argued that the greater balance in intra-European exchanges evidenced in recent months indicates that the time has come for removing restrictions which are no longer needed for balance of payments purposes and are being maintained as purely protectionist devices. The answer is that the present near-equilibrium position has been achieved with the aid of restrictions. There is no way of telling what the pattern of intra-European exchanges would be if all restrictions were suddenly removed, but there is a strong possibility that in some cases serious disequilibria would attend such a removal. The effects of recent attempts to reduce quantitative restrictions are not necessarily indicative of what would happen if all restrictions were generally removed. It is well known that in carrying out their undertaking to eliminate quantitative restrictions on 50 per cent of their trade with each other, European countries have removed
primarily restrictions that were already inoperative or whose removal was not expected to produce any great increase in imports. The only case of genuine liberalization is that of Germany, and it has produced the reversal in that country's position in intra-European trade to which we have already referred. The full effects of the policy of trade liberalization will be felt only when all restrictions have been removed, for so long as countries are allowed to maintain some restrictions they can be relied upon to maintain those that are the really effective ones in restricting their imports.

Finally, the demand for liberalization of intra-European exchanges wholly ignores the effects of higher exchanges within Europe on the region's dollar earning capacity. European exports to the United States consist of a relatively small range of specialized goods, whose main characteristics are high quality and a long tradition in producing them. Many of these goods would have a ready market in Europe if present restrictions on non-essential imports were removed, while exporters would find it infinitely easier and more profitable to sell these goods in Europe than in the United States. In the case of many of these goods the possibility of expanding production is limited by shortages of skilled labor. It is difficult to see how some diversion of these goods to European markets can be avoided if present restrictions on imports of non-essentials are removed. Similar considerations may apply to travel. There is at present a severe shortage of suitable hotel accommodation in Europe, which keeps prices high and deters thousands of Americans from spending their vacations in Europe. The removal of present restrictions on travel within Europe is bound to produce a further increase in the demand for accommodation, drive prices up and discourage Americans from going to Europe. This actually happened last year, and it is difficult to understand why it should be further encouraged. All the proposals for liberalized intra-European exchanges forget the fact that European demand competes directly with American demand for many of the goods and services which offer the best
prospects of increasing Europe's dollar earnings.

Our conclusion is that, while it is worth trying to reduce restrictions in intra-European exchanges and do away with bilateralism, an indiscriminate removal of all restrictions and the wholesale abandonment of bilateral arrangements would be hardly calculated to promote the restoration of equilibrium in European external accounts and the attainment of independence from American aid.

(b) Dollar payments within Europe.

A central feature of the ECA proposals is the provision that net balances within Europe would have to be settled in dollars. In view of the world-wide dollar shortage, the dependence of Europe on American assistance and the small likelihood which exists that Europe will be able to earn sufficient dollars by 1952 to finance even essential purchases in North America, the question comes naturally to the mind whether an arrangement to settle balances within Europe in dollars is feasible and whether it would serve a useful purpose. In our view, the answer to this question should be an emphatic no.

Let us examine, first, the structural surpluses and deficits which would be financed with ECA aid during the period of American assistance and with earned dollars after the termination of American assistance. As already stated, before the war certain countries in Europe, notably Britain and the Netherlands, tended to spend more in other European countries than they earned from them and financed the deficit with dollars earned from their overseas investments and colonial trade. The main recipients of these dollars appear to have been Belgium, Germany and possibly France. Now Britain and the Netherlands have lost all their sources of dollar income and are struggling to find enough dollars to pay for essential imports from North America. Is there any reason to believe that their earnings of dollars will increase so substantially in the coming years that they would not only be able to buy all the goods they need from North America, but would also have dollars to spare to settle deficits in Europe? If such expectation is unrealistic,
does it not follow that these countries can no longer afford to import more from Europe than they export to it, and must either expand their exports to the region or reduce their imports from it? Is there any significance in saying that these countries have structural deficits with Europe other than that they tend to develop deficits with Europe unless they do something about it? If this is the actual position, what good will it do to Europe to have American dollars support for two years a pattern of trade which it will not be possible to maintain when American aid is withdrawn? Would it not mean pretending that a problem which existed did not exist and postponing necessary adjustments?

The notion that structural deficits and surpluses are part of the natural order of things in Europe originates in Belgium, i.e., in a country which during the last four years has earned large amounts of dollars in intra-European trade and continues to hope that intra-European trade will remain its principal source of dollars even after American aid to Europe comes to an end. What this approach forgets is that before the war other European countries freely chose to have an import surplus with Belgium and, because their currencies were convertible, this surplus enabled Belgium to earn dollars from them. Today these countries do not want to have such a surplus, and their currencies are not convertible in dollars. To ask them to enter into special arrangements whereby they would have to provide dollars in settlement of any balances that would accumulate against them in a system of unrestricted intra-European exchanges is equivalent to asking them to earmark for use in intra-European trade an unknown proportion of their future dollar earnings, however inadequate these earnings and however large the dollar obligations and needs for dollar goods which these countries may have to meet.

If such undertaking were given it could easily produce a situation as preposterous as the following: A country like Britain, finding herself short of dollars, would have to cut down her purchases of American goods to the point of having to go without such virtual necessities as tobacco, but would at the same time be spending
dollars on such luxuries as out-of-season fruits and vegetables, silks, velvets, lace, simply because they came from Europe and this was one of the features of European integration.

Apart from the fact that the dollars will not be available to take care of net balances accumulating in intra-European exchanges, how does this requirement for dollar settlements square with the aim of knitting together the European countries into a closer economic partnership? Is it not the characteristic of an economic unit that it is in balance with itself? Does the American economy require foreign currencies to settle its internal transactions? And if transactions within the region are to depend on the ability of members to supply an outside currency to the system, will this not restrict the scope of intra-European exchanges?

If the concept of structural deficits and surpluses requiring settlements in dollars is incompatible with the realities of the present European situation as well as with the aim of an economically unified Europe, the use of dollars for the settlement of other deficits is indefensible from any point of view. Such other deficits can arise only from the following circumstances: inflation in the country experiencing the deficit, deflation in countries which are major trade partners of the country experiencing the deficit, undue liberalization of trade in the deficit country, inappropriate exchange rates, capital flight which reduces the country's receipts or increases its payments on current account. It will be noted that these are all circumstances calling for corrective action on the part of the countries concerned or for the maintenance of restrictions on their external transactions. The question is: is it reasonable to utilize scarce dollars to finance such disequilibria merely in order to prove that corrective action is necessary? And if a country had found it impossible, because of the political and social factors involved, to remedy a situation which weakened her position not only in intra-European payments but also in many other respects, is it likely
that the loss of dollars in intra-European trade would be a sufficiently strong incentive to act, especially when the dollars are provided by ECA? In our view, such a method of forcing countries to restore equilibrium in their payments position is likely to prove both wasteful and ineffective.

The same applies to the credits that would be used to settle that part of the deficits that would not be financed through dollars. Countries would be undertaking debt obligations and encumbering their future resources merely because, during a given period, their economic weakness and a premature removal of restrictions produced deficits in their intra-European payments. Nor is it likely that the countries which found themselves unable, for obviously serious reasons, to tackle effectively their internal economic weakness would be induced to do so merely because they would be accumulating debts.

These are objections of principle against the ECA proposals. Let us now see how those proposals would work out in practice.

ECA is expected to make dollar allocations to European countries for the purpose of covering structural surpluses and deficits. It is difficult to see on what basis these allocations would be made. The pre-war surpluses and deficits, even if they were known, which they are not, have obviously nothing to do with present-day conditions. The deficits of the last four years have been incurred while trade restrictions were being maintained in intra-European exchanges and trade was on a bilateral basis. It is not possible to foresee what the deficits will be when the restrictions are removed and bilateralism abolished. On the other hand, these deficits had been incurred when the relative values of currencies were still out of line and inflationary pressures were still strong. There is no way of telling what the situation will be when these conditions have been removed. There is, in fact, no valid basis for making the precise quantitative estimate of structural deficits or surpluses suggested in the ECA proposals. Any allocations that would be made for such purpose would, therefore, be wholly arbitrary and, as in the case of drawing rights, it is more likely that the facts
will be made to fit the allocations than that the allocations will fit the facts.

Assuming, however, that the allocations are made, what would happen to the dollars that would be contributed by ECA to the Union for structural and other deficits? Who would get them and for what purpose would they be used?

If the allocations for "structural" surpluses correspond to the facts, then the bulk of the dollars allotted by ECA to the Union would go to the countries which are "structural" creditors in intra-European payments. The remaining dollars that would be used for settling intra-European balances would presumably go to the countries with the relatively more sound internal financial situation, including, of course, the countries practicing outright deflation, as well as "structural" creditors to the extent that their internal financial situation makes them also ordinary creditors. If the allocations for structural surpluses do not correspond to the facts, then the bulk of the dollars allotted to the Union would remain unutilized. This is so because if the countries to which "structural" dollars have been allotted do not develop surpluses, they obviously cannot get the dollars, while the countries that do develop surpluses, not having been allotted "structural" dollars would have to grant credits against part of their surpluses and would earn dollars only on the balance. If, for instance, ECA decides that Belgium is a structural creditor and that France is not and allots "structural" dollars to Belgium but not to France, and if subsequently, it is France that proves to be the structural creditor and not Belgium, France, unlike Belgium, would not be entitled to a 100 per cent settlement of its structural surplus in dollars, but would have to grant credits to cover part of its surplus and would receive dollars only for the balance. The "structural" dollars would, however, remain unutilized. The situation would be still more complicated if a country classified as a "structural" creditor is revealed to be only an ordinary creditor, while another country is the true "structural" creditor. In that case, the ordinary creditor would receive the "structural" dollars, while the structural creditor would have
to extend credits and would receive dollars for only part of his surplus.

Inversely, a country receiving an allocation for a structural deficit can run a deficit of that amount with the group without having to make any payment. A country which does not receive such allocation must settle any deficit she incurs in dollars and debt obligations. If the allocations fit the facts, the purpose of the plan is fulfilled. If they do not, a country would have her deficit entirely financed by Union resources simply because she has been classified as "structural" debtor, while another country who may be a "structural" debtor would have to make payments in dollars and undertake debt obligations simply because she has not been classified as a "structural" debtor.

While it is obviously impossible to foresee how things would work out in practice, it is reasonable to expect that the allocations made by ECA would exercise considerable influence on the pattern of intra-European payments, and might even decide who is the structural creditor and who is the structural debtor. This is so because a country to whom "structural" dollars have been allotted is likely to exert herself to the utmost in order to get these dollars and might even be prepared to enforce some deflation in her economy in order to make sure that she earns the dollars. A country who has received no such allocation, even if she has a tendency towards a surplus, is likely to take steps to avoid developing such a surplus if this entails the granting of credits and only limited dollar settlements. Inversely, a country who has received an allocation for a "structural" deficit is likely to do everything possible to develop the deficit, while a country who has no allocation is likely to do the opposite in order to avoid dollar payments and debt obligations. An interesting question that may arise is whether a country declared to be a "structural" creditor would be entitled to devalue her currency if the earning of the dollars allotted to her depends on such devaluation. Would, for instance, Belgium, a "structural" creditor according to ECA, be justified in devaluing her currency if she could not
develop a surplus at the prevailing rate of exchange?

Assuming then that the ECA dollars go to the "structural" countries and to the countries with the relatively sounder or even deflationary internal situation, how would they be utilized? It is clear that the countries receiving the dollars would be free to use them as they like. They may purchase essential commodities in the Western Hemisphere, including capital goods, for the improvement of their productive capacity. But they may decide to use them on any other type of imports, including luxuries, or to accumulate them in order to increase their reserves. One of the chief arguments advanced in favor of using part of the ECA appropriations for the settlement of balances in intra-European trade is that it would enable ECA to reward countries whose policies promote the cause of European recovery and penalize countries whose policies do not. There is everything to be said for relating dollar allocations to the performance of individual countries rather than to their need for dollars as determined by their deficits. Otherwise, there is no incentive for a country to cut down her deficits and reduce her dependence on American aid. The question, however, is: would the ECA dollars injected in intra-European trade be rewarding countries that would be promoting Europe's independence from American aid, and would their subtraction from the funds available for direct dollar allocations be penalizing the countries that do not pull their weight in the common effort? In our view, they would be doing quite the opposite. They would be going to countries which expect to earn their dollars indirectly through the efforts of other countries and they would be denied to countries which, if given larger allocations of direct dollar aid, would utilize it to obtain essential materials and machinery in North America in order to improve their productive capacity, increase their ability to earn or save dollars, and thus achieve independence from American aid. Such a method of allocating ECA dollars is likely to result in a substantial amount of this year's allocation remaining unutilized in the Payments Union or in the hands of
"structural" creditors, while essential imports from North America would be curtailed and valuable productive projects abandoned. It is difficult to see how this is likely to contribute to European recovery and to the attainment of independence from American aid.

Even if the strengthening of European reserves at the expense of dollar imports is considered as a desirable objective at the present stage of the European Recovery Program, would the allocation of dollars that would result from the operation of the European Payments Union represent the best way of distributing the dollars? A rational distribution would require that the dollars go to strengthen those reserves which have been most dangerously depleted since the war. These are not the ones that are likely to be strengthened through the operation of the European Payments Union.

(c) Maintenance of equilibrium in intra-European exchanges.

We have seen that the ECA proposals envisage primarily two types of action for correcting excessive debtor positions in intra-European exchanges, namely, internal financial measures and exchange rate adjustments.

There will no doubt be cases where this would be the type of action called for by the existing situation. But if a country, for a variety of reasons, is unable to take steps along such lines and continues to run deficits with the group, would it not be preferable to allow her to maintain quantitative restrictions on her imports than to let her for a time waste the resources of the Union and in the end have her ejected from the group?

On the other hand, there will certainly be cases where the measures envisaged in the ECA proposals would not be the most appropriate ones to meet the situation and might actually prove far more harmful to intra-European exchanges than quantitative restrictions. Countries whose structural deficits prove to be so large that they cannot be wholly taken care of through ECA allocations would, according to the ECA proposals, be required either to enforce a deflation in their
economy to the detriment not only of their own people but of their European partners as well, or to devalue their currencies, which may not be out of line. Similarly, countries who have depended more on quantitative restrictions than on tariffs to maintain equilibrium in their external accounts might find that with the abolition of quantitative restrictions they are importing more from other countries than these other countries, who have kept their tariffs, are importing from them. It is obvious that neither deflation nor devaluation is the appropriate solution in such a situation, but rather a lowering of tariffs by the other European countries. Finally, countries which pursue a policy of full employment might develop deficits simply because other countries follow deflationary policies. In this case the duty to take remedial action should lie with the creditor countries and not with the debtors.

It is important to realize that situations may arise in intra-European exchanges under which the aims of unrestricted trade and dollar settlement of balances would not be compatible with exchange stability and the maintenance of high levels of employment. The ECA proposals would require European countries to sacrifice the latter in order to maintain the former. This is not likely to prove acceptable to countries who are committed to full employment policies and do not share ECA's doctrinaire dislike of restrictions.

Prospects of adoption of the ECA proposals for a European Payments Union.

As already stated, it is impossible to foresee how intra-European payments would develop if all restrictions on current transactions were abolished and full transferability of currencies were established. It is not inconceivable that the pattern that would emerge would not be more unbalanced than the present one. This, however, is highly improbable. In our view, there is a strong possibility that in such a system Britain would emerge as a very large debtor. We base this view on the following considerations: (a) Britain, as already stated, has a
tendency to spend more in other European countries than she earns from them.

(b) For nearly two decades Britain has carried out her commercial transactions with some of the other European countries on a bilateral basis. The abandonment of bilateralism might reveal that Britain's position in intra-European trade is much weaker than appears to be the case at present. (c) There is still considerable inflationary pressure in Britain, while in other European countries inflation has disappeared and has even given place to deflation. A removal of all restrictions on imports from Europe may result in a very large import surplus. (d) There is still considerable inflation in the sterling area which, according to the ECA proposals, would be included in the Payments Union. A removal of restrictions by the countries of the sterling area might again result in large import surpluses. (e) Sterling balances and British capital exports are keeping the world supply of sterling considerably larger than the demand and weaken the international position of sterling. This, in spite of the strenuous efforts made by Britain to cut down her foreign spending and expand the sales of her products abroad. Experience during the last three years shows that wherever possibilities of converting sterling into dollars or other hard currencies exist, holders of sterling will find ways of using them even if that means surrendering their sterling at considerable discount. It is this pressure of non-commercial sterling rather than any weakness in Britain's external position on current account which explains the heavy gold and dollar losses suffered by Britain during the short-lived attempt at convertibility in the summer of 1947 and ever since. The Payments Union, with its expanded opportunities for converting sterling into other currencies, including dollars, would provide new facilities for such transactions, and there can be little doubt that they would be fully exploited. It is, therefore, probable that considerable amounts of non-commercial sterling would find their way into the system and go to swell Britain's obligations towards the Union.
Britain's unwillingness to accept the ECA proposals as they now stand reflects her awareness of these weaknesses in her position and her reluctance to enter into arrangements whose effect might be to undermine her currency and deplete her reserves. It is probable that before subscribing to any plan for a European Payments Union Britain will insist on the following conditions:

(a) freedom to decide whether she can afford to abandon bilateral trading;
(b) freedom to maintain or reimpose quantitative restrictions if the relaxation of these restrictions leads to excessive imports from Europe; (c) safeguards that she will suffer no serious losses of gold or dollars as a result of her participation in the Union.

It is clear that acceptance of these conditions would produce a drastically watered-down version of the ECA proposals. The choice seems to be between this and establishing the Union without Britain's participation. In our view, the latter course would not make sense, and it is, therefore, probable that the changes in the proposals required to meet British objections will be accepted by ECA.

The fact that Britain is the only country which has expressed strong reservations against the ECA proposals should not be interpreted as indicating that without this British opposition the proposals would have been accepted in their present form by the rest of Europe. Many other countries are likely to balk at committing themselves to dollar settlements after the termination of ECA aid even without British opposition or even to the removal of all restrictions. It is probable that any plan that would have been finally accepted would have included sufficient escape clauses to make the obligations undertaken not very binding ones.

The need for a broader approach to the problem of European payments.

To say that indiscriminate liberalization of intra-European exchanges and premature attempts at convertibility are neither possible nor desirable is not to deny that an effort must be made to organize these exchanges on a more
rational basis. In our view, the effort would be most fruitful if it were made along the following lines:

(a) It must be recognized that no structural surpluses or deficits will be possible in intra-European exchanges after the termination of American aid. This means that the aim of a European Payments Union should be to maintain an over-all balance in intra-European exchanges with seasonal or temporary deficits taken care of through mutual credits. Subject to this condition, every effort should be made to attain the maximum degree of freedom in intra-European exchanges compatible with the paramount need of expanding Europe's trade with the outside world and especially the dollar area.

(b) The purpose of a European Payments Union should not be to subject intra-European exchanges to a special and exclusive regime, but only to provide a nucleus around which all European external transactions could gradually be built. The successful functioning of the Union for one or two years should make it possible to expand the scope of its operations and gradually attract to it most of the non-dollar world, and especially Latin America, Asia and the countries of the sterling area, as full members. Thus would be created a large trading area with the maximum freedom of exchanges and convertibility of currencies compatible with the realities of its members' position. Europe would immensely benefit from such accretions of members which would enable her to trade with non-European countries on a far more satisfactory basis than that afforded by present bilateral deals. The advantages that non-European countries would derive from participation in the system would be equally great, enabling them to buy and sell with the maximum of freedom in an area which is now hedged with restrictions and controls.

(c) This effort to free transactions within the non-dollar world should not divert attention from the still more important task of solving the dollar problem. If the effort to increase the world's earnings of dollars on current and capital account succeeds, convertibility of the Union's currencies into
dollars and a high volume of trade with the dollar area would naturally follow. An increase in the world's ability to earn dollars is the only way of attaining a genuine convertibility of currencies. Schemes like the replenishment of the world's reserves out of American gold are no substitute for such an increase in earned dollars. So long as the world continues to buy more from the United States than it sells to it and borrows from it, any gold reserves, however large, are bound to be exhausted in time and to flow back to the United States. If the effort to increase the world's earnings of dollars fails, there will at least be a large area in the world where international specialization would be possible, advantageous exchanges could take place and transactions could be relatively free. As pointed out in an American publication, "a world economy organized on this basis would unquestionably be less progressive and more subject to commercial restrictions and discriminations, but it is an altogether possible one."

(d) The strengthening of sterling is an essential condition for the success of any effort to free international transactions. In view of Britain's position as the most important trading nation of the non-dollar world and of the prominent role she has played and still plays in international finance, the standing of her currency exercises a decisive influence on the whole pattern of international economic relations. As already stated, the present weakness of sterling arises mainly from the excessive payments on capital account represented by sterling releases and capital exports. It has been suggested that the burden of sterling debts is too heavy for Britain to carry alone and that United States aid should be made available to help her liquidate these debts. We do not believe that this is necessary or even desirable. Britain can take care of these debts herself if her creditors do not insist on excessive releases and if she

herself does not use debt repayment as a means of maintaining employment at home or gaining special advantages in foreign markets. A reasonable settlement involving payments which are within Britain's capacity to make would be no real sacrifice to the creditors because it would strengthen the currency of which they hold such large amounts and would enable them to get better value for their assets. In the long-run, a slower rate of debt repayment would serve the interests of the creditors much better than the excessive releases of the last few years, a large part of which had been dissipated in easy spending.

9. Conclusions:

We have discussed in detail the issues raised by the American desire to see Europe integrate its economy because we believe that they are issues of crucial importance to the Western World, involving, as they do, the very foundations of Western cooperation and mutual understanding.

Our conclusion is that a real integration of the European economy that would produce the spectacular gains expected by Americans is not a practical proposition and is not likely to be realized in the foreseeable future, however great the pressure that may be exerted on Europeans and whatever the promises Europeans may find necessary to make.

The American approach to the European problem suffers from two basic weaknesses: (a) It is built on a false analogy with American conditions, and (b) it takes little account of the desires and attitudes of the Europeans themselves. Americans have failed to understand the European mood in this matter. The fact that Europeans have not openly challenged the validity of the American approach has been interpreted as acceptance of the American thesis, while all it meant was that Europeans, depending on American aid, have preferred to avoid starting an argument on an issue which aroused American emotions. The recent stiffening of the European, and especially the British, attitude reflects the greater confidence with which Europeans are facing the future rather than any
change of mind about the desirability of integration. In our view, American pressure for integration is not only unlikely to produce any concrete results, it may do actual harm to the cause of European recovery to which Americans have so sincerely dedicated themselves. The harm that can be done is two-fold:

(i) Valuable time and energy is being wasted on an unreal issue while the urgent problem of reducing Europe's dependence on American aid remains unsolved. Devaluation should have been the signal for a fresh start in the trade relations between Europe and the United States and a joint effort to solve the dollar problem. Instead, ECA concentrated all its attention on the secondary issue of intra-European exchanges. The psychological moment for making a serious attempt to expand European exports to the United States has been allowed to slip away, and the opportunity of doing something constructive about the dollar problem may already have been lost. For this, the American insistence on integration may have to take part of the blame.

(ii) The mutual resentment and recriminations which may result from this divergent interpretation of Europe's problem may affect the whole climate of relations between Europe and America. Americans desire so passionately to help bring about Europe's unification that they tend to disregard the ill-feeling their pressure may create. The danger in this situation is that while the pressure for integration will not accomplish much, the ill-feeling it may produce may be difficult to dissipate. In our view, mutual understanding is more important to the Western partnership than any material gains that may result from integration. For such understanding to exist Americans must try to see the problems facing Europe in the light of the European, not the American, experience, and Europeans must try to do the same about American problems. Unless they succeed in developing such an attitude, their partnership will continue to be a precarious one and will be in danger of break-up at the first show of Russian reasonableness.
By this time next year the issue of integration which is at present exer-
cising the Western World will probably have been disposed of by events which do
not argue but happen. It will, however, be a pity if meanwhile American
ergies and the American desire to help have been expended in pursuit of un-
attainable aims.

C.—THE DOLLAR SHORTAGE AND CONVERTIBILITY

1—Progress in European production and trade.

If the American approach to the European problem is excessively con-
structive the European approach is insufficiently so. Americans may be asking
the impossible in Europe but Europeans tend to err in the opposite direction
and to take a rather negative view of a problem which calls for all their
efforts and energies in order to be solved.

The considerable increases in European production and trade which have
taken place during the last year have created the feeling that the region's
continuing dependence on American aid arises from American, not European,
policies and requires American, not European, action for its solution.

This theory was first expressed in the 1949 Report of the Economic
Commission for Europe which contended that, with the European recovery in
production, the problem of Europe's balance of payments had become a primarily
American problem "since it is necessarily the surplus area that must choose
which of a number of alternative solutions it desires to adopt, while the
deficit areas will necessarily have to adapt themselves to the particular
solution adopted". This thesis has now become a feature of most statements
on the problem emanating from Europe. In our view it is more of an attempt
to explain away Europe's failure to tackle her dollar problem in a constructive
manner than a correct interpretation of the present situation.

In the first place a region which is still unable to purchase commodities
vital to its economy cannot claim that it has solved the problem of its recovery,
The fact that some of these commodities happen to be in surplus supply in another region is no justification for saying that it is up to that region to decide what must be done about the problem of maintaining the flow of these commodities to the region that needs them. It is enough to ask what would happen to the European economy if Americans decided to curtail the production of these commodities to the level of commercial demand alone to realize that the problem of securing for Europe the food and raw materials at present financed with American aid is as much Europe's as anyone else's concern.

In the second place it is not true that, apart from the difficulty of marketing goods in the dollar area which arises from American action, Europe has completed her recovery and solved her production and trade problems. There is still much to be done in Europe before that stage is reached and the contrary impression is more of a statistical illusion than a view which corresponds to the facts.

European industry has made great gains since the end of the war and especially since the 1947 crisis was overcome with the help of the European Recovery Program.

Between 1948 and 1949 industrial production is shown to have increased as follows in the most important ECA countries: 1/

<table>
<thead>
<tr>
<th></th>
<th>Per cent increase between 1948 and 1949</th>
<th>Per cent increase between Jan. and Oct. 1949</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>6.2</td>
<td>6.7</td>
</tr>
<tr>
<td>France</td>
<td>10.0</td>
<td>4</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10.6</td>
<td>10</td>
</tr>
<tr>
<td>Belgium</td>
<td>2.6</td>
<td>2</td>
</tr>
<tr>
<td>Sweden</td>
<td>5.9</td>
<td>2.5</td>
</tr>
<tr>
<td>Norway</td>
<td>5.6</td>
<td>7</td>
</tr>
<tr>
<td>Denmark</td>
<td>4.4</td>
<td>12</td>
</tr>
<tr>
<td>Italy</td>
<td>9.1</td>
<td>24</td>
</tr>
<tr>
<td>Total ECA countries excluding Germany</td>
<td>8.4</td>
<td>8.8</td>
</tr>
<tr>
<td>Germany</td>
<td>48</td>
<td>17.8</td>
</tr>
<tr>
<td>Total ECA countries including Germany</td>
<td>12.7</td>
<td>10.0</td>
</tr>
</tbody>
</table>

The following increases occurred in the output of some basic industries:

<table>
<thead>
<tr>
<th>Industry</th>
<th>Per cent increase between 1948 and 1949</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hard coal</td>
<td>+ 9</td>
</tr>
<tr>
<td>Crude steel</td>
<td>+ 16</td>
</tr>
<tr>
<td>Production of wagons and locomotives</td>
<td>- 10</td>
</tr>
<tr>
<td>Merchant ships launched</td>
<td>+ 15</td>
</tr>
</tbody>
</table>

In terms of value the total increase in manufacturing production between 1948 and 1949 may be estimated to have been of the order of $7 billion.

In spite of this improvement, present levels of production do not justify the claim that there is no longer a production problem in Europe. That claim is based on statistical calculations which show that the level of industrial production in ECA countries, excluding Germany, had increased by 29% as compared with prewar:

<table>
<thead>
<tr>
<th>Country</th>
<th>Level of Industrial Production in ECA countries 1938 = 100 1949</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>136</td>
</tr>
<tr>
<td>France</td>
<td>122</td>
</tr>
<tr>
<td>Belgium</td>
<td>116</td>
</tr>
<tr>
<td>Netherlands</td>
<td>125</td>
</tr>
<tr>
<td>Sweden</td>
<td>161</td>
</tr>
<tr>
<td>Norway</td>
<td>132</td>
</tr>
<tr>
<td>Denmark</td>
<td>141</td>
</tr>
<tr>
<td>Italy</td>
<td>107</td>
</tr>
<tr>
<td>All ECA countries excluding Germany</td>
<td>129</td>
</tr>
<tr>
<td>Germany</td>
<td>74</td>
</tr>
<tr>
<td>All ECA countries including Germany</td>
<td>115</td>
</tr>
</tbody>
</table>

An examination of the methods used in compiling these indices reveals that they hardly deserve the confidence with which they are quoted by government

1/ Excluding Western Germany.
2/ The value of manufacturing output in ECA countries has been estimated by OEEC at $60 billion in 1949.
British statistics are probably among the best and most objectively compiled. Those who compile them, i.e. the Central Statistical Office, have frankly stated that "it is impossible to obtain an exact measure, and difficult to obtain even a rough idea, of the comparative levels of production before and after the war". Merely by using a different basis for calculating relative prices the estimates may be made to vary as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Weighted by relative prices in 1935</th>
<th>Weighted by relative prices in 1946</th>
</tr>
</thead>
<tbody>
<tr>
<td>1938</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>1946</td>
<td>102</td>
<td>96</td>
</tr>
<tr>
<td>1949</td>
<td>132 2/</td>
<td>124</td>
</tr>
</tbody>
</table>

The difference is accounted for by the fact that commodities for which output rose between 1936 and 1946 (e.g. electricity, steel, cigarettes) rose less in price than those for which it fell (e.g. coal, cotton goods).

An independent compilation made by the London and Cambridge Economic Service shows much smaller increases in output:

1938 = 100

<table>
<thead>
<tr>
<th>Year</th>
<th>Weighted by Relative Prices in 1946</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Central Statistical Office</td>
</tr>
<tr>
<td>1946</td>
<td>96</td>
</tr>
<tr>
<td>1949</td>
<td>124</td>
</tr>
</tbody>
</table>

If British indices of production suffer from serious imperfections, those of other countries are still less reliable as a measurement of changes in the volume of output which have taken place since the war. British indices have a


2/ Obtained by assuming that the increase between 1946 and 1949 was the same on both bases.
wide coverage - the Central Statistical Office uses 400 indicators, the London and Cambridge Economic Service 250. For Belgium only 33 series are used, for the Netherlands 100, for France 169. "Many of the individual series used are known to be defective. Many of the weightings have no census of production behind them. In at least one instance there has been a serious break in the continuity of collecting statistics owing to the war, so that detailed checking of records from year to year on which uniformity in production statistics largely depends is ruled out."

Apart from much weaknesses in the compilation of the data, these statistical measurements of production often completely ignore the question of quality. Much of the coal at present produced in Europe is of inferior quality as compared with prewar, which means that more of it is needed to accomplish a certain task than before. But in measuring production tonnage is the only consideration taken into account. The same applies to calculations made for steel, textiles, manufactured foods and so on. In these statistical measurements, one yard of cloth is equal to one yard of cloth irrespective of whether the amount of labor required to produce one type of cloth is twice as great as that required for another. One pint of beer is equal to one pint of beer irrespective of whether postwar beer is a watered-down version of the prewar variety. The pitfalls are not less serious when value measurements are used. In that case the change in output is inferred from the change in value corrected for price rises, which are usually understated in most official calculations of prices.

The fact that the amounts of industrial materials consumed by European industry appear to have increased much less than industrial output is another reason for suspecting a considerable upward bias in European indices of production. The Report of the Economic Commission for Europe pointed out that between 1938 and 1948 production rose much faster than imports of industrial materials and

it attributed this divergence to greater economy in the use of these materials and increased use of home-produced materials. One wonders, however, whether part at least of the divergence is not due to exaggerated estimates of increases in industrial production.

Our conclusion is that official statistics probably overstate the increases in industrial production which have taken place in Europe by a substantial amount and should not therefore be uncritically accepted as evidence that European industrial production has made spectacular gains as compared with prewar.

Another reason why the picture of industrial production derived from these statistics is misleading is that the indices quoted are usually based on the year 1938 which was a year of exceptionally low economic activity and was not typical of prewar levels of production. The most useful comparison is with the best prewar year, 1937. Taking 1937 as a basis we find that the increases usually quoted are reduced as follows:

<table>
<thead>
<tr>
<th>Industrial Production</th>
<th>1938 = 100</th>
<th>1937 = 100</th>
</tr>
</thead>
<tbody>
<tr>
<td>All ECA countries excluding Germany</td>
<td>129</td>
<td>121.6</td>
</tr>
<tr>
<td>Germany</td>
<td>74</td>
<td>79</td>
</tr>
<tr>
<td>All ECA countries including Germany</td>
<td>115</td>
<td>112.7</td>
</tr>
</tbody>
</table>

1/ The recent OECD Report contains the following information on the consumption of some industrial materials as compared with prewar:

<table>
<thead>
<tr>
<th></th>
<th>1935-38</th>
<th>1948</th>
<th>1949-50</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coal</td>
<td>100</td>
<td>95</td>
<td>104</td>
</tr>
<tr>
<td>Oil products</td>
<td>100</td>
<td>129</td>
<td>152</td>
</tr>
<tr>
<td>Electricity</td>
<td>100</td>
<td>130</td>
<td>152</td>
</tr>
<tr>
<td>Copper</td>
<td>100</td>
<td>96</td>
<td>106</td>
</tr>
<tr>
<td>Cotton</td>
<td>100</td>
<td>79</td>
<td>89</td>
</tr>
<tr>
<td>Wool</td>
<td>100</td>
<td>108</td>
<td>115</td>
</tr>
<tr>
<td>Artificial fibers</td>
<td>100</td>
<td>140</td>
<td>200</td>
</tr>
<tr>
<td>Softwood</td>
<td>100</td>
<td>76</td>
<td>82</td>
</tr>
</tbody>
</table>
In the case of France, the 1937 basis reduces the level of production in 1949 from 122% of prewar to 109. In the case of Belgium instead of a level equal to 116% of prewar, we obtain a level only 94% of prewar. In the case of the United Kingdom, the expansion is reduced from 136 of prewar to 126 or, if building is included, to 122. Using 1946 weights instead of the 1935 used in this calculation, we obtain an index of only 114. Using the data of the London and Cambridge Economic Service, we find that the 1949 index would be 110 if 1935 weights are used and only 104 on 1946 weights. Thus, we get a series of indices ranging from 136 to 104 with the lower indices probably nearer the truth than the higher ones.

But even 1937 was a year of considerable unemployment in European industry. In that year, there were 1,500,000 unemployed in the United Kingdom corresponding to 10% of the insured population, and 400,000 in France. In 1949, on the other hand, unemployment was practically nonexistent in these countries. The fact that resources of manpower and productive capacity which were idle in 1937 are now fully utilized goes a long way towards explaining the increases in industrial production which have taken place since the war and suggests that there has been no substantial overall increase in industrial capacity or productivity as compared with prewar but mainly a fuller utilization of available resources. This, of course does not mean that individual European industries have not expanded their productive capacity. A considerable expansion has taken place in heavy industry, partly in order to offset the loss of German supplies and partly in order to take care of reconstruction needs, but there has been little expansion or even a decline in other industries so that on balance, the industrial potential of Europe does not appear to be much greater than before the war.

This must be taken into account in appraising the extent of European recovery. European industry has made very important gains since 1947 which have dispelled the fear then expressed that Europe might be suffering from a fatal

deliberation and have demonstrated that the European industry remains one of the most vital factors in the world economy. But the gains made are not such as to justify the complacency with which some Europeans view the progress achieved, even less to suggest that Europe's recovery problem has been solved. This is so for the following reasons:

(i) If most of whatever increases in industrial output have taken place since the war are due to increased employment and not to higher productivity, it follows that pari passu with the increase in output there has been an increase in the claims made on the total resources of the community by those producing that output. Formerly unemployed workers are now receiving a full wage while the bargaining power of all workers has been strengthened by the disappearance of unemployment. This means that the total purchasing power available to the working class is likely to have increased by more than the increase in output and to have upset the balance which formerly existed between demand and supply. Such a balance can be restored only if output per worker increases. European industry must aim at further increases in production through a higher level of productivity per worker if financial stability and equilibrium are to be achieved in the European economy. Present levels of output remain insufficient to take care of the increased purchasing power resulting from full employment. Still less are they sufficient to take care of the demand for improved living standards which have existed in Europe since before the war and is the main cause of the social and political instability prevailing in the region.

(ii) An increase in employment produces an increase in the demand for food and raw materials. European agricultural production is not higher than before the war and imports are, if anything, below prewar levels. It follows

---

1/ Even when official indices are accepted at their face value, output per man-year does not appear to have risen by more than 10% as compared with 1938 (excluding Germany). When Germany is included no rise in productivity is indicated.
that food supplies are not sufficient to meet fully the present demand and industrial materials are not as plentiful as they should be. This produces inflationary pressures and a diversion of demand on export goods which impair the region's ability to sell its commodities in foreign markets. Before these conditions are removed both European agriculture and European imports of primary products must increase above present levels.

Western Europe cannot and should not try to become self-sufficient in agricultural products since this would necessarily be at the expense of the region's living standards. But better farming practices and the application of up-to-date techniques can produce a substantial increase in yields which may relieve the present pressure on agricultural supplies. European recovery cannot be considered as completed before these steps are taken and agricultural output expands above present levels. Similarly, an increase in European imports of primary products requires an increase in the present export capacity of European countries.

(iii) The fact that European exports have reached prewar levels is no justification for claiming that Europe's overall foreign trade problem has been solved. For full European recovery, European exports will have to be considerably larger than before the war not only because of the greater demand for imports arising from the higher level of European production, but also in order to take care of the loss in investment income and of the rise in the prices of primary products which have taken place since the war. European foreign trade, in spite of the gains made in 1949, is still far from having reached the level and pattern required for real economic equilibrium.

\[1/\] Consumption of rain foodstuffs in 1949-50:

\[
\begin{array}{ll}
\text{Bread grains} & 103.7 \\
\text{Coarse grains} & 95 \\
\text{Fats and oils} & 103.8 \\
\text{Meat} & 83 \\
\end{array}
\]

2/ Imports valued f.o.b.
Overall European exports increased by nearly $2 billion between 1948 and 1949 while imports declined by some $600 million, thus reducing Europe's overall trade deficit from some $5 billion in 1948 to approximately $2.5 billion in 1949. A deficit of that size was compatible with overall balance on external accounts since receipts from invisibles were not far short of that total. The impression of near-balance derived from these global estimates is, however, completely shattered when the figures are more closely scrutinized.

In the first place, total European imports of some $20 billion in 1949 were probably still below the volume of a depressed prewar year like 1938. This low level was the result of shortages abroad and of import restrictions maintained because of inability to purchase larger quantities of imports. At that level imports did not provide the European countries with all the supplies required for a normal functioning of their economies. Thus the equilibrium achieved on the import side was a very precarious one depending for its maintenance on severe restrictions and considerable shortages. It is not an equilibrium compatible with full recovery.

Exports at $18 billion were also below prewar in volume at a time when industrial production was shown to have increased by 15% as compared with prewar. The exclusion of Germany raises the volume of both imports and exports to approximately prewar levels, but, considering that industrial production is shown to have increased by 29% when Germany is excluded, a volume of foreign trade only equal to that of a depressed prewar year is clearly not sufficient for full recovery.

In the second place the extent to which European countries were able to finance these limited imports through earned resources is much less than overall export figures suggest. It has been a feature of postwar European trade that

1/ Imports valued f.o.b.
2/ Imports valued f.o.b.
3/ Imports in 1938 were approximately $10 billion (f.o.b.) and since import prices have risen by more than 100%, the volume of imports in 1949 must have been smaller than in 1938.
4/ Exports in 1938 amounted to $9 billion. Export prices rose by more than 100% between 1938 and 1949.
exports have tended to flow to soft currency areas while imports were coming in larger proportions from the dollar area and were being financed through the liquidation of reserves, borrowing or American grants. This feature continued in 1949. While total European exports increased by some $2 billion as compared with 1948 exports to the United States and Canada actually declined, reducing the proportion of exports going to North America from 7.8% of the total in 1948 to 6.3% in 1949. Similarly exports to Latin America in 1949 were not larger than in 1948.

European exports have continued to be attracted to soft currency areas through higher prices and easier selling conditions. The financing facilities provided by the large capital exports to soft currency areas which the major European countries have allowed to take place as well as by the $800 million drawing rights granted under the Intra-European Payments Scheme have supported and encouraged this direction of European exports. Thus the overall trade deficit of $2 billion in 1949 concealed a dollar deficit of some $4 billion and a surplus with soft currency areas of $2 billion. The total surplus with these areas was larger than this figure since payments for investment income and other invisibles should have enabled European countries to have an import surplus with these areas.

Such a pattern of trade can be maintained only so long as exceptional American aid is available to finance the import surplus from the dollar area. This is so not only because without such aid a considerably larger proportion of European exports would have had to be sold to the dollar area but also because without the raw material imports coming from the dollar area much of the output of textiles, metals and other goods going to soft currency areas could not have been produced.

Our conclusion is that the task facing European countries is far from having been completed. The attainment of independence from American aid and
the establishment of real equilibrium in the European economy require further increases in European production and exports, not of the indiscriminate type which raises the indices of production while doing little else to restore balance in the European economy, but of the type that will improve the region's ability to pay for imports essential to the functioning of its economy. For such increases to be achieved it will be necessary to expand production of those goods which are demanded by overseas suppliers of primary products. Since devaluation, European prices for a wide range of goods are fully competitive with American prices and the chief obstacle to an increase in exports lies in the insufficiency of supplies and the unavailability of commodities of the type demanded by Europe's overseas customers.

The problem of achieving a high volume of trade with suppliers of primary products involves more than an increase in European production. A development of the greatest importance in the postwar world economy is the fact that, while world industrial production has increased considerably above prewar, world production of primary products is barely at prewar levels. Trade in such commodities, if Government-subsidized exports from the United States are excluded, is below prewar levels because of higher consumption in the producing countries themselves. In order to be able to secure a larger volume of imports of primary products, Europe must develop production in its own overseas territories, induce other primary producers to expand their output or import more from the United States. The first course requires heavy capital investment and is often uneconomic. The second course requires a reversal of economic policies in primary producing regions. The bitter experience of the 1930's has induced many of these regions to push industrialization at the expense of primary production and foreign trade. This remains to this day the aim of economic policy in most of these regions. It is only if European countries can offer them the promise of steady and profitable markets for their primary products and if at the same time they can
supply them with cheap manufactures that they can demonstrate to them that their interests are better served in producing primary products for the world market than in turning out costly manufactures for the home market. The third course requires a determined effort on the part of Europeans to earn dollars through exports of goods and services to the United States and other countries of the dollar area. In all cases larger imports of primary products will be possible only if Europeans improve the quality and quantity of goods entering foreign trade and direct a larger proportion of their exports to areas which can supply them with essential commodities. Before this has been done, it cannot be said that Europe has completed her recovery, even less can it be said that the problem of her balance of payments is a matter of indifference to her and is a problem calling primarily for American action.

2—European plans and prospects

The thesis that the solution of Europe's balance of payments problem is an American responsibility is a theoretical construction. European countries are too vitally affected by the condition of their external accounts to leave the issue to another country. The plans recently summarized in the OECD Report indicate how European countries intend to face the problem of their internal and external unbalance in the coming years.

The following table shows how the production of some basic commodities is expected to expand between 1949-50 and 1950-51:

<table>
<thead>
<tr>
<th>Production</th>
<th>1949-50</th>
<th>1950-51</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coal</td>
<td>112</td>
<td>116</td>
</tr>
<tr>
<td>Oil products</td>
<td>163.3</td>
<td>207.2</td>
</tr>
<tr>
<td>Electricity</td>
<td>114</td>
<td>120</td>
</tr>
<tr>
<td>Crude steel</td>
<td>123</td>
<td>129</td>
</tr>
<tr>
<td>Hot finished steel</td>
<td>126</td>
<td>131</td>
</tr>
<tr>
<td>Artificial fibers</td>
<td>152</td>
<td>167</td>
</tr>
<tr>
<td>Consumption</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Copper</td>
<td>110</td>
<td>128</td>
</tr>
<tr>
<td>Cotton</td>
<td>113</td>
<td>115</td>
</tr>
<tr>
<td>Wool</td>
<td>106</td>
<td>111</td>
</tr>
<tr>
<td>Softwood</td>
<td>107</td>
<td>107.5</td>
</tr>
</tbody>
</table>
The OEEC Report estimates that the plans imply an increase in overall industrial output between 1950 and 1952 of some 5 – 6%... This would mean that by 1952 the level of industrial production would be 15 – 20% higher than in 1937 on the basis of official statistics and probably less on the basis of actual facts.

Agricultural production is expected to increase only slightly above present levels and to be at approximately prewar levels in 1950-51.

Foreign trade plans similarly do not suggest that any substantial expansion is contemplated:

(billion dollars)

<table>
<thead>
<tr>
<th></th>
<th>1949-50</th>
<th>1950-51</th>
<th>1951-52</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports</td>
<td>16.40</td>
<td>17.22</td>
<td>18.13</td>
</tr>
<tr>
<td>Imports</td>
<td>20.34</td>
<td>19.93</td>
<td>19.96</td>
</tr>
</tbody>
</table>

These figures, being expressed in dollars, do not measure the increase in volume which is expected to take place between 1949 and 1952 because they do not take into account the fact that prices in soft currency areas, with which Europe conducts the bulk of its trade, will not rise by anything like the increase in the value of the dollar following the recent devaluations. The figures, as they are, do not, however, indicate any substantial expansion in foreign trade.

Plans for tackling the dollar problem indicate that the brunt of the adjustment will be borne by imports and that only a limited contribution is expected from expanded exports:

(billions of dollars)

<table>
<thead>
<tr>
<th></th>
<th>1948</th>
<th>1949-50</th>
<th>1950-51</th>
<th>1951-52</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports to the dollar area.</td>
<td>1.68</td>
<td>1.44</td>
<td>1.76</td>
<td>2.09</td>
</tr>
<tr>
<td>Imports from the dollar area.</td>
<td>6.42</td>
<td>4.94</td>
<td>4.31</td>
<td>3.78</td>
</tr>
</tbody>
</table>
As compared with 1949-50, reductions in imports are expected to contribute $1.16 billion while the expansion in exports will contribute only $0.6 billion. At the level planned for 1951-52 imports from the dollar area will be 32% below their 1949-50 volume and for countries like the United Kingdom they will be only half their prewar volume. These reductions will arise from both a diversion of purchases to other areas and a cutting down of imports of the commodities involved;

<table>
<thead>
<tr>
<th>Imports of Major Commodities</th>
<th>1949-50</th>
<th>1950-51</th>
<th>1951-52</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Payable in:</td>
<td>Payable in:</td>
<td>Payable in:</td>
</tr>
<tr>
<td></td>
<td>Gold</td>
<td>Other currencies</td>
<td>Gold</td>
</tr>
<tr>
<td>Agricultural products</td>
<td>1,935</td>
<td>5,425</td>
<td>1,659</td>
</tr>
<tr>
<td>Chemicals</td>
<td>164</td>
<td>614</td>
<td>144</td>
</tr>
<tr>
<td>Fuel</td>
<td>482</td>
<td>1,432</td>
<td>438</td>
</tr>
<tr>
<td>Iron and steel</td>
<td>121</td>
<td>684</td>
<td>90</td>
</tr>
<tr>
<td>Non-ferrous metals</td>
<td>310</td>
<td>583</td>
<td>315</td>
</tr>
<tr>
<td>Textiles</td>
<td>567</td>
<td>2,507</td>
<td>586</td>
</tr>
<tr>
<td>Other raw materials</td>
<td>258</td>
<td>1,803</td>
<td>243</td>
</tr>
<tr>
<td>Machinery and equipment</td>
<td>938</td>
<td>1,423</td>
<td>664</td>
</tr>
<tr>
<td>Other manufactures</td>
<td>117</td>
<td>846</td>
<td>127</td>
</tr>
<tr>
<td>Total</td>
<td>4,892</td>
<td>15,317</td>
<td>4,266</td>
</tr>
</tbody>
</table>

Even at that low level there will be a dollar deficit on trade account of nearly $2 billion. The total dollar deficit will be larger since there will also be a deficit on invisibles and a dollar deficit with other areas and for other
purposes than current transactions. Estimates contained in the OEEC Report show the following picture:

**Gold and Dollar Deficit of ECA Countries**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade deficit</td>
<td>-5,886</td>
<td>-4,294</td>
<td>-3,279</td>
<td>-2,389</td>
<td>-1,652</td>
</tr>
<tr>
<td>Net invisibles</td>
<td>-499</td>
<td>-144</td>
<td>-153</td>
<td>-111</td>
<td>-82</td>
</tr>
<tr>
<td>Net current balance</td>
<td>-6,385</td>
<td>-4,438</td>
<td>-3,432</td>
<td>-2,500</td>
<td>-1,734</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2. With other dollar countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net current balance</td>
</tr>
</tbody>
</table>

| 3. Other dollar transactions | -612  | -359  | -343    | -430    | -473    |

<table>
<thead>
<tr>
<th>4. Dollar balance of overseas territories and associated monetary areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>-276</td>
</tr>
</tbody>
</table>

| 5. Total gold and dollar deficit | -8,500 | -5,622 | -4,373  | -3,258  | -2,250  |

The $2,250 billion dollar deficit in 1951-52 is expected to be met through the last installment of ECA aid. There is no indication in European programs of what will happen next i.e., of whether there will be an expansion in exports to the dollar area or a further contraction of imports or both. The rate of expansion of exports planned for the next two years does not indicate that increased exports are envisaged as the principal means of closing the deficit while the low volume of dollar imports planned for 1952 makes it doubtful that further reductions are feasible. The programs, as they now stand, strongly suggest that European countries expect a continuation of American aid in some form after 1952. Developments in the American economy during 1949 have probably reinforced the feeling of Europeans that the 1952 deadline need not be taken too seriously. Surpluses of agricultural commodities have been accumulating in the United States at a rapid rate since the summer of 1949 and by the end of 1950 they may represent a Government investment in agricultural
supplies of over $5 billion. There is little indication that a downward
adjustment in production is contemplated for the next few years and it is likely
that agricultural commodities will continue to be produced in excess of
commercial demand for some time. If that happens vast supplies of exactly the
type of commodities most urgently needed in Europe will be in the hands of the
American Government and will require disposal in some way or other. The recent
technique of sales at low prices, even nominal prices, adopted by the U. S.
Department of Agriculture may be the form which assistance to European countries
will take after the termination of ECA aid. Europeans are justified in
feeling that so long as these large surpluses continue to exist there need be
no undue worry about 1952. This may explain the confident tone of the recent
OEEC Report which contrasts so sharply with the grave view taken of European
prospects in last year's Report. The statement that Europe's dollar problem
will be of "manageable proportions" by 1952 probably means that the supplies
needed will be there and will somehow be made available.

This, of course is an overall appraisal of European prospects and it
ignores the differences which exist between individual European countries.
For some countries the problem will be far from manageable in 1952. Western
Germany, Austria, Greece and possibly Italy, will probably continue to be as
dependent on American aid and as important from the point of view of American
foreign policy as they are today. Other countries like Sweden, Norway, Portugal,
and Turkey, will probably be wholly self-supporting at the end of the
ECA program. The United Kingdom, France and the Netherlands, will probably
be in an intermediate position. They will have sufficiently recovered not
to be threatened with collapse if no further American aid is forthcoming but
the cessation of such aid may still administer a severe shock to their economies
and force the imposition of severe restrictions and controls. For these
countries American agricultural surpluses hold the promise that such action
will not be necessary.
3—Implications of European plans for world trade and the world economy

European policies, as they now stand, contemplate a limited effort to expand exports to the dollar area, a substantial reduction in imports from that area and continued American assistance in some form beyond 1952.

We have seen that European exports to the dollar area are expected to be of the order of $2 billion by 1951-52. Within that total, exports to the United States and Canada will be $1.5 billion. European programs do not show separate estimates for the United States and Canada but it is probable that, of the $1.5 billion total, exports to the United States will not exceed $1 billion. This may be presumed from the fact that already in 1949 exports to Canada amounted to some $400 million. This $1 billion of exports to the United States compares with $871 million in 1948 and $750 million in 1949. It indicates no increase in volume in relation to prewar. Exports in 1936-38 amounted to $585 million and prices in dollars have nearly doubled. It is clear that European countries do not believe in the desirability of expanding their exports to the United States. The contention that the American tariff does not allow larger exports is hardly convincing since even without the substantial reductions in duties which have been effected during recent years, the rise in the American national income should have permitted a much larger volume of imports from Europe than before the war. In 1936-38 imports from ECA countries corresponded to approximately 0.9% of American national income. At the level planned for 1951-52 they will be barely 0.5% of that income. Taking into account the lowering of tariffs which has taken place meanwhile, one may confidently state that exports from Europe equivalent to 1% of the American national income would have been a reasonable and wholly attainable goal. Such exports, amounting to $2.2 billion, would not have solved Europe's dollar problem but they would have made possible an increase of some 25% in Europe's planned imports from the dollar area and this would have benefited Europe no less than American producers.
There are three main reasons why Europeans, in spite of the opportunities offered by devaluation, show no desire to expand their sales in the American market. First, they doubt that Americans can be reconciled to larger imports. Second, they have become accustomed to the easy markets of soft currency areas and can no longer stand the intensity of competition prevailing in the American market. Third, they are confident that American surpluses will, for some time, continue to take care of their needs. The disturbing thing about this European attitude is that it makes it difficult to measure the extent to which Americans have abandoned their former economic isolationism. It is at least possible that the American reaction towards larger imports would not have been as violent as expected, that American consumers would have come to like the greater variety, better quality and lower prices of imported goods and that, as a result, imports of foreign manufactures would have increased over the years, bringing the American economy and the American people closer to the European economy and to the people of Europe with whom they have so many affinities.

A similar development occurred in the 19th century when Britain opened her market to foreign manufactures and became one of the world's largest importers not only of primary products, but also of industrial goods. The European unwillingness to expand exports to the United States may be holding up a development dictated by the logic of events.

Europeans profess to believe that their real chance for earning dollars lies in large American investments in underdeveloped regions. They point out that such investments, if not tied to the export of American products, would result in a substantial demand for European machinery and equipment, and thus enable Europeans to earn dollars with which to buy American primary products. In our view, this is a wholly unrealistic expectation, not only because the flow of American capital abroad is not likely to be large, but also because there is very little chance that underdeveloped countries will want to spend more than a fraction of their borrowed dollars on European products.
Furthermore, investment fluctuates from year to year and such earnings of dollars, even if they are occasionally realized, cannot become a steady source of finance for the payment of currently needed food and industrial materials.

With European countries earning only $1 billion in their trade with the United States and maintaining severe restrictions on imports from the dollar area and with the American Government selling large quantities of agricultural supplies at artificial prices, the pattern of Western economic relations in the 1950's does not promise to be far different from what it has been in the last few years. With such a pattern so clearly forming before our eyes, any expectation that multilateralism and convertibility can be restored in the foreseeable future belongs from now on to the sphere of wishful-thinking.

4—Conclusions

The European Recovery Program set out to accomplish two aims: (a) to help in the restoration of the European economy and in the revival of Europe as a major political factor in world affairs and (b) to create conditions that would make possible greater freedom in international transactions and thus hasten the attainment of multilateralism and convertibility, the two major objectives of American postwar economic policy.

The program has now reached its half-way mark and it is already clear that as far as the first aim is concerned it has been an unqualified success which has fully justified the expenditure and effort on the American side. It is equally clear that there has been little success with regard to the second aim. In a way this is a tribute to American statesmanship which has placed the broader interests of the Western community above American preferences and American commercial interests. It is also a striking evidence of the contribution which high levels of economic activity can make to the improvement of economic relations between nations and contrasts sharply with the
frustrating experiences and bitter economic antagonisms which were typical of the 1930's. No less satisfying is the disappointment of Communist expectations that rivalries for foreign markets would wreck the Western association.

The aim of freer international transactions and of a larger volume of world trade is, however, a worthwhile aim which, even if it could not have been immediately realized, promised to contribute to world prosperity and progress. The European Recovery Program has failed to promote that aim. On the contrary, with its emphasis on making Europe independent of American supplies it has often tended to work in the opposite direction. For this both Americans and Europeans are to blame. The American insistence on "integration" has sidetracked the problem, encouraged exchanges within Europe instead of between Europe and the outside world and diverted attention from the major need of expanding European exports to the dollar area. The preference of Europeans for the easy trading conditions of soft currency areas and their distrust of the United States as a commercial partner have been chiefly responsible for the failure of American imports to expand to a level commensurate with the international position of the United States and with the acuteness of the world shortage of dollars.

It may or it may not be too late to change these policies and seek more rational solutions which would conform to the declarations made by both sides that their policies aim at freer world trade and eventual convertibility of currencies. The attempt should no doubt be made. In our view, however, political and other factors make it highly unlikely that present trends will be reversed. The pattern of the last few years will probably be maintained with discrimination, restrictions and exceptional Government measures as its main features, while convertibility and multilateralism remain a vague and distant goal.