Appendix I

On Economic Union

ECONOMIC union between adjacent countries is widely canvassed today for two reasons. The first is to facilitate discrimination against the United States of America and its deflationary export surplus. Such discrimination, as we have seen, is very desirable, but economic union is rather a big project to use in order to achieve it. The simplest way to bring about this discrimination is for nations to make a joint demand on the United States to appreciate the dollar; or alternatively to effect a joint depreciation of non-dollar currencies. Or discrimination can be effected simply by agreeing to cut dollar imports as much as possible, while relaxing controls on imports from non-dollar sources.

The more important and permanent case for economic union is that, in reducing obstacles to trade, it widens the market and promotes international specialisation. Opponents of union point out that this is not always advantageous to the countries concerned. For example, suppose that before union A and B buy a certain commodity from C, and that after union between A and B the industry is successfully established in A at the expense of C. If the natural economic advantages are heavily in favour of C, both A and B may be worse off for encouraging the industry to establish in A. This is perfectly true, but is not perhaps very important. For what is probable, in the absence of union, is not that the industry will be confined to C, but that both A and B will try to establish it at home under protection, and, compared with this situation, economic union which confines the protection to a large industry in A, is decidedly superior to the prospect of two smaller industries in A and B, both protected. Moreover, C's advantage frequently consists in nothing more than that C has a large market free of trade barriers, and if union does the same for A and B this 'unnatural' advantage disappears. There can be little doubt that if the trade barriers between European countries were removed, all Europe would benefit immensely from the resulting stimulus to specialisation.

It must be emphasised that it is greater specialisation that is the principal benefit. Some people, for example, argue for union on the ground that it will permit greater 'coordination' of industries, by which they mean increased cartelisation. For example every European country is trying to have its own motor car industry, and this is clearly wasteful because the advantages of large scale operation in this industry are immense. If coordination means sharing out the market between the various national industries, through some form of international cartel, the effect will be pernicious. What we really need is that most of these national industries should be swept away, and the whole European market opened up to the product of a very small number of manufacturing centres.

Here lies the rub. Economic union is very difficult to bring about because it is bound to sweep away a great many national practices to which people cling. Let us consider the difficulties systematically.

First of all, what do we mean by economic union? The term covers many degrees of cooperation, and is very loosely used. The minimum requirement is that the currencies of the union should be freely interchangeable without restriction or licence; this does not itself imply union—it was the 'normal' relation between currencies for over a century—but it is the first step. Secondly the decision to free currencies is nullified if at the same time other trade barriers are raised, such as tariffs, or import quotas. The minimum requirement is an undertaking not to increase such barriers, and the union begins to have substance only if there is an undertaking to remove barriers, either immediately or in gradual but pre-determined stages.

When the union comes into effect two sets of problems at once emerge; those that affect particular industries and those that relate to trade in general.

Industries are affected because they lose their protection, or because the removal of barriers in other countries widens their markets. Omelettes cannot be made without breaking eggs, and increased specialisation cannot be achieved without destroying some existing trades. Governments must therefore be ready with plans to move resources out of distressed industries to those that may now expand (including plans to move skilled workmen from one country to another, if this is desirable and if they want to go). But they must turn a deaf ear to suggestions for protection, or the union cannot come into existence. On the other hand they must be ready to remove artificial restraints or subsidies which they themselves have imposed. For example, if there is free trade between Britain and France there cannot be heavy excise duties on beer in Britain but not in France, or British brewers will take their industry to France. This means that all countries in the union must have the same structure of indirect taxation, and of subsidies to industries; union is not just a matter of currencies and tariffs.

The fact that the union destroys some industries is tolerable because it also expands others. But it does this only if it stimulates exports as much as imports, i.e. only if it does not lead to unbalanced trade. For example, if Britain and France now entered into union, Britain would have a heavy export surplus to France, and many French industries would be wiped out while very few would expand. This is because French prices are much higher than British prices. The next step towards union is therefore to bring the price levels of the countries concerned into line with each other. This is not difficult; we have only to find the right rate of exchange between currencies and to establish this rate before the union commences.

The great problem is then to keep the price levels in line in the future. A union cannot last long if one country is trying to stabilise prices and wages, like the U.K., while another is inflating, like France, and a third pursuing a deflationary policy, like Italy. Therefore economic union involves at least an agreement between all the countries concerned to pursue the same policy with respect to money, prices, wages, investment, and employment; and since it is difficult to carry out such an agreement, the logical end of economic union is to have a single government responsible for such matters.

The exception which proves this rule is the working of the sterling pool. Here we have a group of freely interchangeable currencies, without specific agreement to pursue a common economic policy, and indeed without any real similarity of policy. But in the first place the sterling group is not a full economic union. Each partner is free to adopt, and does adopt, measures that partly nullify the free convertibility. Thus British farmers are not overwhelmed by cheap produce from the dominions because the United Kingdom does not permit unrestricted entry of produce even from countries within the sterling group; and free convertibility of currencies does not carry us far when the physical movement of goods is otherwise restrained. And in the second place, even with these restrictions the existence of free convertibility gives rise to problems that are solved only because the political ties existing between the members of the group permit much give and take. Three of these problems are outstanding. First, because sterling is inconvertible, several members of the group receive in return for their exports only an addition to their holdings of sterling, just as in economic union with France we would receive for exports a large holding of inconvertible francs; in the case of the sterling group, members are willing to hold sterling without complaint because of their affection for the United Kingdom, but in the case of economic union we should not be so willing to send exports to France in return for a holding of francs. Secondly, each member agrees to pool its dollar earnings, and the Treasury is allowed, in consultation, to determine how many dollars each member may spend. Malaya surrenders dollars to the sterling pool, and the United Kingdom also makes substantial contributions (proceeding from loans) for the benefit of other members of the group. Belgium might not feel so generous to other members of an economic union. Nevertheless it is essential in such a union that earnings of non-union currencies be pooled. Otherwise each country has the incentive to withhold its goods from union members and to direct its exports as much as possible say to dollar countries, thus frustrating the free movement of goods intended by the union. And thirdly, even in the sterling area movements of capital from one member to another give rise to anxieties, and are carefully watched. These difficulties are overcome in the sterling group because the members are prepared, because of their common membership of the Empire, to accept some sacrifice; and those members of the Empire which cannot afford the drain that would otherwise be upon them stay out of the group. In an economic union of Western Europe the difficulties would be even more acute, because the economies of the countries are much more competitive (the sterling group countries are more complementary), and would therefore more urgently have to pursue similar economic policies; while on the other hand the will to give and take, which smoothes the working of the sterling area, would not be so pronounced.

It would be virtually impossible to carry on an economic union in Western Europe without having a political union with a central government responsible for economic policy. This is not a strange conclusion when we remember the problems presented by local authorities within a unitary state, or by state governments within a federation. If local authorities were free to pursue conflicting monetary policies a country would soon be in a mess. We recognise as an elementary principle of political economy, that if there is to be free movement of men, money and goods inside a country, whether unitary or federal, then there must be severe limits on the economic powers of subordinate authorities. We apply this principle even to the provision of social services. If one area has elaborate services and high taxes, while others have fewer services and smaller taxes, business is driven from the high to the low tax area, and this will be true whether the areas are Yorkshire and Lancashire, Pennsylvania and Illinois, or England and France. An economic union, in fact, will not long work smoothly unless it becomes a political federation, with the more important economic functions of government transferred from the state to the federal authority.

Now it is a pre-condition for this further stage that countries should agree broadly to pursue similar economic policies. A union between *laisser-faire* peoples is easy to achieve, because each of the peoples knows that the federal authority will pursue the same sort of economic policy that its own national government would have pursued. But a people that favours planning cannot live in the same federation with a people that favours *laisser-faire*. And even the peoples that favour planning cannot agree on a federation unless the types of planning that they favour are broadly similar.

The great obstacle to plans for economic union in Western Europe is the unplanned and unstable economy of France. So long as France continues to abandon herself to inflation al other countries have to protect their economies against her, and there is not much hope of barriers coming down. But if France can pull herself together, and establish a strong administration, the main obstacle to economic union will fall away. For the principal countries of Western Europe have now all abandoned *laisser-faire* (all their political parties agree on this), and it would not be impossible (though it would not be easy) to reach agreement on the general lines of economic policy, and even to surrender some crucial economic powers to a federal authority. Or it may be, on the other hand, that participation in economic union is just what France needs to ensure a sound economic policy.

In the last analysis the success of economic union depends on the strength with which political union is desired. The difficulties are formidable, but once it comes to be realised that the very continuance of democracy in Western Europe depends on the nations finding military and political strength in unity, the economic obstacles will be seen to be of little importance.