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Three Essays on the Common Market

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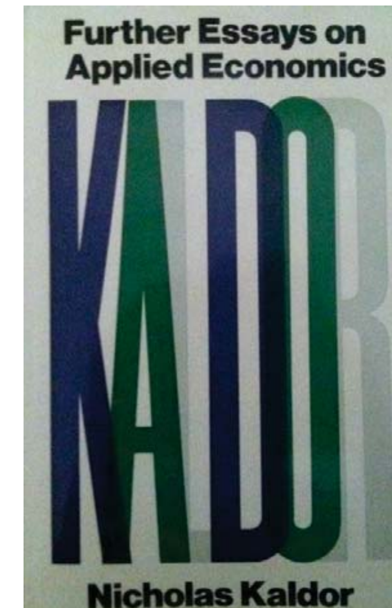

THE DYNAMIC EFFECTS OF THE COMMON MARKET[1]

IT is generally agreed that the initial effects of joining the Common Market are likely to be unfavourable to Britain, mainly owing to the heavy cost of assuming the obligations of the Common Agricultural Policy. It is argued however that these unfavourable impact effects are likely to be more than offset by the long-term advantages—the so-called "dynamic effects" of membership. Last year's White Paper on *Britain and the European Communities*[2] described the nature of these advantages in the following terms:

> "For industry and trade, the main consequences of United Kingdom membership of an enlarged community would be that we should form part of a Customs Union of up to 300 million people stretching from Scotland to Sicily and from the Irish Republic to the borders of Eastern Europe. Within this vast area, industrial products would move freely—without tariff or quota restrictions—as soon as any transitional period had been completed. And over the years ahead it would be the intention to convert this Customs Union into a full economic union by the progressive alignment and harmonisation of commercial policy, i.e., trading relations with third countries; of economic and fiscal policy; of company and patent law; of standards for industrial products . . . etc.
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> "The creation of such an enlarged and integrated European market would provide in effect a much larger and a much faster growing 'home |iarket' for British industry. It would provide the stimuli of much greater opportunities—and competition—

[1] First published in the *New Statesman,* 12 March 1971, and later in the volume *Destiny or Delusion? Britain and the Common Market,* London 1971. [a] Cmnd. 4289, February 1970.

> than exists at present or would otherwise exist in future. There would be substantial advantage for British industry from membership of this new Common Market, stemming primarily from the opportunities for greater economies of scale, increased specialisation, a sharper competitive climate and faster growth. These may be described as the 'dynamic effects' of membership on British industry and trade. It has not been found possible to measure the likely response of British industry to these new opportunities nor, therefore, the effects on our economic growth and balance of payments."[1]

In the concluding section the White Paper strikes an even more confident note about the "dynamic effects" resulting from membership of a "much larger and faster growing market":

> "This would open up to our industrial producers substantial opportunities for increasing export sales, while at the same time exposing them more fully to the competition of European industries. No way has been found of quantifying these dynamic effects but, if British industry responded vigorously to these stimuli, they would be considerable and highly advantageous. *The acceleration in the rate of growth of industrial exports could then outpace any increase in the rate of growth of imports* with corresponding benefits to the balance of payments. Moreover, with such a response, the growth of industrial productivity would be accelerated as a result of increased competition and the advantages derived from specialisation and larger scale production. This faster rate of growth of productivity would, in turn, accelerate the rate of growth of national production and real income."[2]

The same argument has been repeated in other documents[3] but without adding anything of substance to the case as presented in these quotations. There are frequent references to the fact that the countries of the E.E.C. have experienced much higher growth rates than the U.K. since the war, with the implication that if

[1] Gmnd. 4289, paras 52-3.
[2] Para. 77. Italics not in the original.
[3] See for example, Confederation of British Industry, *Britain in Europe: A second industrial appraisal,* January 1970.

Britain formed part of the Community, her own growth rate would be assimilated to that of the other members. Since the rate of economic growth of the U.K. has been so much lower than that of the countries of the Common Market—around 3 per cent, a year, in the period 1958-69, as against 5-4 per cent, for the Six— this in itself would establish a strong presumption in favour of joining the Community.

But whether any such tendency can be presumed to exist or not is a matter that requires closer analysis of the causes of high and low growth rates, and of the effects of increased competition on growth. It cannot be taken for granted as a self-evident matter that the intensification of competition between different industrial regions brought about by a Customs Union will automatically enhance the rate of growth of *each* of the participating regions taken separately.[1] Indeed, as the italicised passage of the White Paper indicates, the favourable effects on our growth rate depend on the hypothesis that opportunities created by the Common Market will lead to an acceleration in the rate of growth of industrial exports which will "outpace any increase in the rate of growth of imports". But what if the response were the other way round, with an acceleration in the rate of growth of imports that "outpaced" any increase in our exports? It could not then be maintained that the rate of growth of national production and real income would be higher as a result; on the contrary, the effect would be to make our rate of economic growth lower than it would be otherwise, or even to make it negative. The question in other words, is not only one of "quantifying" the magnitude of these "dynamic effects" but of discovering, in the first place, whether they should be entered on the credit side or the debit side.

The White Paper is certainly correct in suggesting that the

[1] There is certainly no evidence to show that the creation of the Common Market enhanced the rate of economic growth of *each* of the participating countries taken separately, or even of the area as a whole. The rate of economic growth of the Six countries taken together was lower in 1958-69 than in 1950-58, while the rates of growth of other O.E.C.D. countries (both inside and outside Europe) were higher in the latter period than ft the former. The formation of the Customs Union seems to have clearly benefited Italy (which increased its share of total trade in manufactured goods, both inside and outside the Community) and probably also Belgium, but there is no clear evidence in the case of the others. Cf. R. L. Major and associates, *Another Look at the Common Market,* National Institute Economic Review, November 1970, pp. 29-43. For reasons adduced below, the experience of the Six 'countries is not necessarily relevant from the point of view of the effects of entry on the U.K.

"dynamic effects" on our growth rate are likely to be far more important over a run of years than the "impact effects", however large the latter may be. An increase in our growth rate, by one per cent.—that is, from say 3 per cent, to 4 per cent, a year—is likely to compensate for the initial cost of entry in three years even if the latter is as much as 3 per cent, of our national income, or £1,200 million a year. Conversely, a 1 per cent, diminution in our growth rate is likely to double the annual cost of membership in three years, treble it in six years, and so on.

The basic question therefore is whether entry into the E.E.C. is likely to have a favourable effect on our growth rate or an adverse one. This question cannot be answered without considering the more fundamental question of what makes the rate of growth of productivity relatively fast in some countries and relatively slow in others.

The argument that follows is wholly in accord with the White Paper's own intellectual approach to the problem—-the question is only whether the White Paper's optimistic conclusions concerning our growth rate follow from their premises.

CAUSES OF HIGH AND LOW GROWTH RATES

There is a substantial amount of evidence in favour of the view that causes of high and low rates of productivity growth of various countries or regions are closely bound up with the rates of growth of manufacturing production. There are two main reasons for this. The first is that economies of large-scale production, due to ever-increasing differentiation and subdivision of processes, are peculiar to manufacturing ("processing activities") as distinct from either primary production (agriculture or mining) or tertiary production (transport, distribution and miscellaneous services). The second is that in the sectors other than manufacturing (chiefly in agriculture but also in services) there is in most countries a considerable surplus of labour (some kind of "disguised unemployment") so that when the manufacturing sector expands and draws more labour from other sectors, these other sectors are not forced to curtail their output; on the contrary their output will also tend to increase if they provided goods or services that are complementary (or

ancillary) to manufacturing activities. Hence the faster manufacturing output expands, the faster productivity will rise, both in the manufacturing sector and in the non-manufacturing sectors.[1]

Added to these is the fact that in "capitalist" economies at any rate the increase in industrial capital necessary for an expansion of output is largely self-generated: the more production expands, the greater is the inducement to invest in the expansion of capacity, and the higher are the profits which provide the finance for such investment.

Under these conditions the economic growth of particular industrial regions will largely be determined by the growth of demand for the products of those regions which emanates from *outside* the region—i.e., the growth of its exports. A faster rate of growth of exports will induce a faster rate of growth of production, an acceleration in industrial investment, and both of these will lead to a faster growth of consumption.

If the world consisted of a single industrial area which sold its products to an outside world of primary producers in exchange for food and basic materials, the growth of demand for its exports would itself be governed by the purchasing power it provided to the outside world either through its purchases of food and raw materials or through foreign investment.[2] In a world however where there are a number of competing industrial regions, the growth of demand for the products of *any one* of these regions will depend, not just on the growth of total demand, but on whether it is gaining or losing in competitiveness—i.e., whether it manages to enlarge its share in the total market, or whether it has to put up with a diminishing share.

[1] Empirical evidence derived from the comparative experience of a number of advanced industrial countries suggests that a 1 per cent, increase in the rate of growth of manufacturing production requires an addition of about 0 5 per cent, to the rate of growth of employment in manufacturing and will be associated with a 0-5 per cent, addition to the rate of growth of non-manufacturing output. (See my paper, "Causes of the Slow Rate of Growth of the United Kingdom", Cambridge University Press, 1966, reprinted in *Further Essays in Economic Theory.)*

[2] This was largely the Situation of Britain in the middle of the nineteenth century when she had a near moilopoly as an exporter of manufactures, and also provided the main world market for food and basic materials. The pace of industrial expansion in Britain rose and fell with exports, which in turn depended on rising or falling primary product prices (which governed the purchasing power of the producers of primary products) and the latter in turn on whether the growth of supplies of primary products ran ahead or fell behind the growth of world demand.

Owing to the existence of economies of scale both comparative success and comparative failure tend to have self-reinforcing effects. Industrial areas tend to become more "competitive" when their growth of productivity is faster than average; but a higher rate of productivity growth is itself the reflection of the faster rate of growth production made possible by the gain in "competitiveness".

Myrdal coined the phrase of "circular and cumulative causation"[1] to explain why the pace of economic development of the various areas of the world does not tend to a state of even balance, but on the contrary, tends to crystallise in a limited number of fast-growing areas whose success has an inhibiting effect on the development of the others. This tendency could not operate if changes in money wages were always such as to offset differences in the rates of productivity increase. This, however, is not the case; for reasons that are not perhaps fully understood, the dispersion in the growth of money wages as between different industrial areas tends always to be considerably smaller than the dispersion in productivity movements.[2] It is for this reason that within a common currency area, or under a system of convertible currencies with fixed exchange rates, relatively fast-growing areas tend to acquire a cumulative competitive advantage over relatively slow growing areas. "Efficiency wages" (money wages divided by productivity) will, in the natural course of events, tend to fall in the former, relatively to the latter—even when they tend to rise in both areas in absolute terms. Just because the differences in wage increases are not sufficient to offset the differences in productivity increases, the comparative costs of production in fast-growing areas tend to fall in time relatively to those in slow- growing areas and thus enhance their competitive advantage over the latter.

[1] *Economic Theory and Underdeveloped Regions,* London, 1957.

[8] The differences in the rates of increase in money wages between industrial countries in the post-war period tended to be small relative to differences in rates of productivity growth. In the last year or two the rate of increase in money wages accelerated very considerably in all major industrial countries, but without creating large differences in the rates of increase of wages between countries. Cf. O.E.G.D. study *Inflation: The Present Problem.* December 1970, Table 8. For further evidence on the relation of changes in competitiveness to differences of productivity growths, see also O.E.C.D. study of An Empirical Analysis of Competition in Export and Domestic Markets in O.E.C.D. *Economic Outlook, Occasional Studies,* December 1970.

Thus Britain's rate of productivity growth has been relatively slow in relation to other "developed" countries mainly because the rate of growth of her manufacturing output was low; the latter was low because the rate of growth of her exports was low; and the latter in turn was low because owing to her relatively slow productivity growth, she was steadily losing ground to her competitors.

If we take the ten years prior to the 1967 devaluation the volume of world trade in manufactures grew at a compound rate of 8-5 per cent, a year. Over the same period U.K. exports of manufactures increased only by 2-5 per cent, a year; her share of world exports fell from 18-2 per cent, in 1957 to 11-9 per cent, in 1967. Over the same period Japan's share of world exports rose from 5-9 to 9-8 per cent.; Italy's from 3-8 per cent, to 7 per cent, and Germany's from 17*5 per cent, to 19-7 per cent. The combined gain in the market shares of these three countries was two- thirds at the expense of the U.K., and one-third at the expense of the U.S. (whose share of world exports also fell from 25-4 to 20-5 in the ten year period).

In a detailed analysis of international competition of engineering products in both domestic and external markets recently published by the O.E.C.D.[1] it is shown that in the five years 1962- 3 to 1967-8 the U.K. lost $2,814 million worth of sales of engineering goods (the equivalent of 13 per cent of her total output in 1962-5) to foreign competitors.[2] Of this total $1,077 million was lost in the domestic market of the U.K.—largely to goods produced in the U.S. and Canada ($545 million) and in the E.E.C. countries ($369 million)—and $1, 737 millions of sales in foreign markets; of these much the greater part, $1,400 million, was in the more distant markets of the Far East, Oceania, Central and South Africa (where Japanese competition was particularly strong). Only $216 million was lost in the domestic markets of the E.E.C. countries. She lost in market share *vis-à-vis* every other producing country; of the total loss of $2,184 million in all,

[1] Cf. O.E.C.D. *Economic Outlook-*. Occasional Studies, December 1970, 'Analysis of Competition in Export and Domestic Markets', by Raoul Gross and Michael Keating.

[2] "Loss" is defined by the difference between the actual increase in sales and the increase in sales which would have been achieved if the market share had remained constant in each market, including the domestic market.

$838 million was lost to U.S. producers, $583 to Japanese producers and $1,179 to producers in the E.E.G. countries; most of the latter was lost however, not in E.E.C. markets themselves, but in the U.K.'s domestic market and in third markets.

These competitive losses were the equivalent of 6-7 per cent, of 1962-3 sales of U.K. products in the U.K. domestic market, 2i*4 per cent, of such sales in the E.E.C. markets, 17*3 per cent, of sales in E.F.T.A. markets and 37*9 per cent, of sales in all other foreign markets. The remarkable feature of these figures is that our losses in E.E.C. markets (where we faced growing tariff discrimination in relation to E.E.C. producers) were only slightly larger than in E.F.T.A. markets (where the discrimination was increasingly in our favour) and in both cases were much smaller than in other foreign markets.

The rapid fall in our market shares shown by these figures was not unavoidable. It could have been largely, if not entirely, prevented if we had taken more prompt and more frequent steps to offset the effects of our growing loss of competitiveness by devaluation. This is best shown by our trading experience in the two years following devaluation. The volume of our exports between 1967 and 1969 grew at an annual rate of 12*7 per cent, (as against the 2*5 per cent, in the ten years up to 1967) so that we managed to maintain our share of world trade almost intact over these two years, despite the fact that world trade grew at an unprecedented rate of 13-5 per cent, a year, or at a 60 per cent, higher rate than during the previous ten years. By 1970, the gain in competitiveness resulting from the 1967 devaluation was at least partially spent; the volume of exports in 1970 is likely to show a rise of only 6 per cent, over 1969 (and most of the increase occurred in the first half of the year) while the volume of world trade as a whole continued to rise at the same rate as in the previous two years.

There can be little doubt, in the light of this experience, that if we had adjusted our exchange rate much earlier, and at more frequent intervals—say a devaluation of 5 per cent, in 1957, repeated in both 1962 and 1967—we should have secured a much better and steadier export performance—say, a compound rate of 6 per cent, a year over the whole period instead of 2-5 per cent, in the decade 1957~67—and this would have meant that industrial productivity

and real income per head would have attained a considerably higher level. For reasons of our economic maturity (the absence of large labour reserves in agriculture and in low-earnings sectors) we could not have equalled the growth rate of countries such as Germany, Italy and Japan (Germany's own growth rate had to slow down quite considerably in the 1960s owing to the appearance of labour shortages) but we *could* have maintained, with a rate of growth of exports of 6 per cent, a year, a rate of growth of G.D.P. of around 4 per cent a year (instead of the 2*7 per cent, actually attained) which would have meant that real income per head (taking into account the adverse effects of devaluations on the terms of trade) would now be at least 10 per cent, higher.

In addition to that our future economic prospects would be more secure. For trade which is once lost is difficult to regain. If we had fought harder, by not allowing ourselves to be "priced out of the market" by the newer and more dynamic competitors (or not so easily) the task of maintaining our position in the future would be less difficult.

The question could legitimately be asked: if a higher rate of productivity growth is so much dependent on the rate of growth of exports, why was there no greater acceleration in the U.K. productivity growth in the years following devaluation, when exports rose three to four times their previous rate? The answer lies mainly in the circumstances surrounding the 1967 devaluation: the need to convert a large deficit into a large surplus in the balance of payments over a short period (owing to the lack of reserves and the pressing need to repay short-term debts) which could not have been achieved except by a severe cut in home demand (through higher taxation, public expenditure cuts and a more stringent credit policy) and this largely balanced the increase in foreign demand. The benefits to be gained from "export-led" growth are long-term: they require an adaptation of the economic structure to a higher growth rate of demand for manufactured goods; a change in both the volume and the structure of capital investment which would come&about gradually, as a result of a steady and sustained stimulus. They require in other words, small and frequent adjustments in the exchange rate (such as could be secured by a free market rate subject to market intervention by the central

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bank); it would be hopeless to expect that the long-term "dynamic benefits" of greater competitiveness could be brought about permanently by a single act of devaluation, however large.

EFFECTS OF THE COMMON MARKET ON COMPETITIVENESS

But can they be brought about by joining the E.E.C.? In the light of our large losses of trade in overseas markets in the post-war period, the idea of a "secure home market of 300 million people" sounds very tempting at first sight as a long-term solution to our problems. But a closer analysis of the likely magnitude of both the costs and the benefits, and the restraints on our freedom of action which would follow from membership of the Community, do not sustain the favourable first impression.

As the issue is a complex one, it is best to tackle its various aspects one by one.

(1) First, what are the benefits of a "larger home market" and what precisely does a "home market" mean in this context? The only tangible gain is free access to the markets of the other members of the Community, in exchange for giving free access to Community producers in the U.K. market. The meaning of "free access" in this connection is the abolition of import duties on U.K. goods which, under the Community's new Common External Tariff, amount to only 7-7^ per cent, *ad valorem,* and the abolition of U.K. customs duties on manufactured imports from the Community, the level of which is estimated at 10-11 per cent, *ad valorem.* Since the E.E.C. market now takes about 25 per cent, of our exports, the benefit gained is the same as a *j\ per cent, reduction of U.K. prices on one-quarter of our exports, in return for a 10-11 per cent reduction in the U.K. prices of rather more than one-quarter of our imports of manufactures. So long as the Community's tariff remains a moderate one, the creation of a customs union cannot in itself make a great deal of difference. We shall derive benefit from a fast-growing Community whether we are inside the Common Market or not—as indeed is shown by the fact that our exports to E.E.C. countries have increased much faster (despite the tariff discrimination) than our exports to other areas. Furthermore the extraordinary new evidence which emerges

from the recent O.E.G.D. study shows that in competition with individual E.E.C. exporters (Belgium, Luxembourg, France, Germany, Italy and the Netherlands) we fared better, in relation to each of the E.E.C. producers, in the "internal" market of the E.E.C. than in "neutral" markets.[1] While the mutual abolition of tariffs is bound to increase the share of each trading partner in the market of the other, in the longer term the growth of our exports to the Community would be subject to much the same competitive influences (both from inside and outside competitors) as if we remained outside. And if the experience of other E.E.C. countries is any guide, we could not hope for more than a modest increase in our share of the E.E.C. market, as a result of being part of the Customs Union.[2]

(2) On the other hand, by joining the Market we should lose the benefit of the existing preferences in favour of U.K. goods in the Commonwealth Markets, in E.F.T.A. and in the Irish Republic.[3] Since these markets account for a much larger share of our total exports than the E.E.C., the net effect of our exports will be adverse: the White Paper estimates that there will be a net loss of exports of ^75-^175 million in consequence. At the same time the net effect on our imports of manufactures are also likely to be adverse, since the abolition of duties on E.E.C. goods will have a greater impact on our imports than the abolition of preferential treatment to Commonwealth goods and to goods imported from those E.F.T.A. members who remain outside. The White Paper estimates the net increase in imports of industrial goods as J£50-£IOO millions, so that the net demand for U.K. manufactures will be adversely affected to the tune of £125-^)275 millions.

(3) This is without taking into account the adverse effects on

[1] Cf. the O.E.C.D. publication referred to, Appendix II, "The Measurement of Possible Trade Discrimination Resulting from Customs Unions", Table II. i. For the purposes of this analysis each E.E.C. country's own domestic market has been excluded from the definition of "E.E.C." markets. For the average of the Six countries the percentage reduction in sales of U.K. goods between 1962-3 and 1967-8 attributable to a reduction of market shares *vis-à-vis* individual E.E.C. producers was 41 per cent, in E.E.C. markets and 63 per cent, in "neutral" markets.

* For evidence of the effects of the E.E.C. on the market shares of member countries in each other's n&rkets see Appendix below.

* In the case of those E.F.T.A members who also join the Common Market, we shall retain the benefit of duty-free entry, and lose only the benefit of the existing tariff discrimination in relation to E.E.C. producers. But in the case of the Commonwealth and those E.F.T.A. members (like Switzerland or Sweden) who are not likely to join E.E.C. we shall lose the benefit of the present preferential treatment altogether.

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real income and on the balance of payments of assuming the obligations of the Community's Common Agricultural Policy. The E.E.C. is a relatively low-tariff area for manufactures but a highly protected area for agriculture. While the tariff on industrial goods is (as a result of the Kennedy round) only 7-7 1 per cent., the average level of effective protection accorded to agriculture—the excess of Common Market prices over world prices—is 45 per cent.[1] By joining the Common Market we therefore face a large adverse change in the relationship of the prices of industrial goods to agricultural goods. There will be a loss on our external "terms of trade" of at least £400 million a year—i.e., our food imports will cost that much more, in terms of our industrial exports[2]— and there will be an equal shift in our "internal" terms of trade, in that the prices paid to our own farmers will cost about £400 million more for the same output as now.[3] The real income generated by the industrial sector at any given level of physical productivity will be reduced on both counts: each unit of manufactured goods produced in the U.K. will buy 20-30 per cent, *less* in foodstuffs than now.

(4) In addition to the loss due to the unfavourable change in price relationships, we shall face the further loss on account of the net contribution to the Community's Agricultural Fund in excess of the receipts from the agricultural levy (which have already been included in the above calculation). This will come to a further £²3°-£4C7° million, depending on the scale of Community expenditure on the support of European agriculture[4] but whether the MansholtPlanis adopted or not it is unlikely that the contribution

[1] See Table 9 of the report by an expert group, *A Future for European Agriculture*, published by the Atlantic Institute, (The Atlantic Papers, No. 4, Paris, 1970).

* This is made up of two components: (i) the higher food prices on goods imported from the Community, estimated around £200 m.; (ii) the levy imposed on food imports from the rest of the world, also around *£200* m. the proceeds of which has to be paid over to the Community, and therefore comes to the same as if we paid higher prices on those imports.

* The present level of E.E.C. agricultural prices is around 27 per cent, higher than the U.K. *guaranteed* prices.

* Under the Community's new financial arrangements we shall have to pay over to the Community—after the end of the transitional period which might be 1978 or 1981 —in addition to the 90 per cent, of the receipts from import levies, 90 per cent, of the receipts from Customs duties (estimated at £240 m.) and up to I per cent, of the value added tax (estimated at £230 m.) or up to £670 million altogether. The return flow from this outlay (in the form of payments by the Community to U.K. agriculture) is estimated at only *£s,o-£ioo* million.

we shall be called upon to make will be much below the maximum that we shall be committed to pay (see Appendix II on the Community's Budget).

(5) This means that in terms of balance of payments cost on current account, we shall start off (apart from the change in the export-import balance of industrial goods referred to above) with a debit of between ^530-^820 million[1] (£400 million on account of the additional cost of imported food; £230-^470 million in further contributions to the Agricultural Fund, *less £50-^100*, million in receipts from the Agricultural Fund) which will have to be covered by additional exports if a deterioration in the balance of payments on current account is to be avoided. To obtain these additional exports, inside or outside the Common Market, we should have to lower our export prices in relation to our competitors (depending on the size of the cost) by 5-10 per cent. This would require an additional devaluation (at the present relationship of our productivity and of our industrial wages to the industrial productivity and wages of our competitors) of 10-15 per cent., which, in terms of the further resources that we would have to transfer from domestic consumption to the balance of payments, means an additional burden of at least ^205-^)340 million.[1] Hence in terms of total resource cost, the balance of payments cost of £650-/) i,[1]25 million is the equivalent of £1,000~£1,500 million.

(6) However this takes no account of the deterioration in our competitiveness on account of the rise in money wages that is bound to result from the rise in the cost of living. The counterpart to the deterioration in the terms of trade is a rise in food prices of 18-26 per cent, (on the White Paper's estimates) which would cause a cut in real wages of 4-5 per cent, for the higher paid workers, and 6-8 per cent, for the lower paid.[2'3] If past (and present) experience is any guide, the rise in food prices will cause

[1] It was a deplorable omission of the White Paper that it failed to take any account of the additional resource cost of the adjustment process in the balance of payments. The requirement for the balance of payments adjustment is the equivalent of £735- *£1,160* million. This estimate also allows for the resource cost of making good the initial reduction in net'exports of manufactures (see Appendix III "The Resource Cost of Entry").

* The range of variation between t8 and 26 per cent, mainly reflects differences of assumptions concerning distributive and retail margins. The higher figure assumes that the percentage addition to first-hand prices on account of wholesale and retail distribution remains unchanged, the lower estimate presumably assumes that the

a compensating rise in wages which will call for *more* devaluation if adverse effects on our exports are to be avoided.

(7) But once we are inside the Common Market, it will be far more difficult to regain competitiveness through adjustments in the exchange rate. One reason for this is that under the Community rules, the prices paid for both imported and home produced food are fixed in terms of "international units" so that whenever the exchange rate is altered, domestic food prices will be raised by the full extent of the adjustment. This increases the real resource cost of achieving any given improvement in the balance of payments; and it means that the rise in the cost of living resulting from devaluation is greater than it would be now. On both these grounds it will be harder to regain competitiveness by devaluation. The second and more fundamental reason is that the possibility of offsetting adverse trends in competitiveness through exchange rate adjustments will itself become impossible as the Community proceeds with its current plans for full economic and monetary union.[1]

The long-term benefits to the U.K. of joining the Common Market depend entirely on attaining a higher rate of growth of productivity. But we could only hope to achieve this if the rate of growth of our industrial production is accelerated, which in turn presupposes, as the White Paper recognises, a faster rate of growth of exports—both absolutely and in relation to industrial imports. For all the reasons listed, this would require a large *initial* cut in the level of our real wages—and salaries—of the order of 10 per

[1] This is discussed on pp. 202-7 below.

amount charged by wholesalers and retailers per unit product remains unchanged— i.e. that distributive margins will be reduced *pari passu* with the rise in prices. The latter is not a reasonable assumption in the absence of price controls.

* Since the White Paper was published last February there has been some rise in world agricultural prices in relation to E.E.C. prices so that at present the excess of E.E.C. prices is more like 40 than 45 per cent. Also the new Government announced its intention to replace the existing system of deficiency payments by import levies; this will raise first-hand food prices by some £250-300 m., and will cause a rise in retail food prices of 5-7 per cent., quite independently of entry into the Common Market. On this basis it has been argued that the addition to the cost of living due to entry into the C.A.P. will only be 2^—3^ per cent., not 4-5 per cent. However, it is too early to say that the improvement in relationship of E.E.C. food prices to world prices is more than temporary (it may well be reversed on the basis of recent forecasts of world production trends); and as to the replacement of the system of deficiency payments by import levies, it is not really relevant to the issue discussed in this paper—i.e., by how much real wages will need to be reduced in order to preserve our competitiveness.

cent, or more, if both the adverse change in the terms of trade, the adjustment in the tax structure, and the need to cover the cost of our net contribution to the Community Fund by additional exports is taken into account—and this in turn is unlikely to be achieved—in any industrial community, not just Britain—by a straightforward reduction in money wages: it will require a succession of downward adjustments in the exchange rate.[1] But owing to the Common Market Agricultural Policy, any act of devaluation will have a greater resource cost in terms of real income and both generates greater inflationary consequences internally and makes the necessary reduction in real wages that much greater; and as the Community proceeds towards a full monetary union, the possibility of devaluation will be ruled out altogether.

If we failed to reduce real wages initially (or failed to reduce them to the extent required)[2] the "dynamic effects" of membership would not be favourable but increasingly adverse. Industrial production and employment would fall, both on account of the deterioration of the trade balance, and on account of the restrictive policies we would be forced to adopt in order to restore the balance of payments and to finance our contribution to the Community. This would be aggravated by an increased capital outflow as domestic industrial investment became unprofitable owing to the fall in domestic demand, and full transferability of capital funds were introduced under E.E.C. rules; and this would necessitate further restrictive fiscal and monetary measures to avoid a balance of payments crisis. In those circumstances the U.K. would become the "Northern Ireland" (or the Sicily) of Europe—an increasingly depressed industrial area, with mass emigration the only escape.

[1] The last occasion in which an attempt was made to achieve a straight reduction of money wages of the order of io per cent, was in the coal-mining industry in 1926, which led to the General Strike.

[2] This "initial" reduction need not of course be attained overnight—it may be spread over five years or more, so that it could be argued that it need not cause an actual *fall* in real wagek, but merely a slowing down in the "normal" rate of increase in real wages. But this argument ignores that during the transitional phase our production is likely to be held back by the need to generate a growing surplus in the balance of payments in which case the rate of productivity growth will also be lower; so that one cannot reckon on the "normal" annual rise in real wages due to the growth of production.

The critical assumptions which lead to this gloomy prognosis are: (a) that we can enter the Community only by assuming the obligations of the Common Agricultural Policy and the relation of E.E.C. agricultural prices to world prices remains much the same as now;[1] (b) that we shall not be able to offset the adverse initial effects on our *industrial* export-import balance by devaluation.

If we could enter the E.E.C. on the same terms as we entered E.F.T.A., and also made sure—by devaluation or by a general cut in money wages—that our industry benefited from entry from the beginning, we might gain considerably through greater industrial specialisation as well as through a higher rate of growth of total output. For the labour-releasing effects of sharper competition (due to the abolition of U.K. import duties on E.E.C. products) would then serve to enhance the growth of our more efficient industries, and the growth of these industries would more than compensate for the decline of the others. On the vital issues of long-term "dynamic benefits" it all depends on whether one starts off on the right foot or the wrong one.

The overwhelming probability is however that just because of the heavy initial cost of entry we shall start off on the wrong foot, and the "impact effects" will then be aggravated by adverse "dynamic effects", not offset by beneficial ones. In that event, entry into the Common Market, if it were really irreversible, would be a national disaster. In reality, this will never happen. Nations do not commit hara-kiri for the sake of international treaties, however solemnly and sincerely entered into. But in addition to incurring the odium of default, we would be blamed for the break-up of Community arrangements, even though this would have happened anyway.

i

THE CONSEQUENCES OF A FULL ECONOMIC AND MONETARY UNION

The events of the last few years—necessitating a revaluation

[1] It is possible that the present high level of agricultural prices would be gradually reoded by inflation if E.E.C. prices remained constant in dollar terms while world garicultural prices rose. The latter does not appear probable at the moment as the current forecasts indicate rising world surpluses in agricultural products. But the continued rise in industrial prices will itself alleviate the adverse effects on our terms of trade if E.E.C. agricultural prices remained constant.

of the German mark and a devaluation of the French franc—have demonstrated that the Community is not viable with its present degree of economic integration. The system presupposes full currency convertibility and fixed exchange rates among the members, whilst leaving monetary and fiscal policy to the discretion of the individual member countries. Under this system, as events have shown, some countries will tend to acquire increasing (and unwanted) surpluses in their trade with other members, whilst others face increasing deficits. This has two unwelcome effects. It transmits inflationary pressures emanating from some members to other members; and it causes the surplus countries to provide automatic finance on an increasing scale to the deficit countries.

Since exchange-rate adjustments or "floating rates" between members are held to be incompatible with the basic aim of economic integration (and are incompatible also with the present system of common agricultural prices fixed in international units) the governments of the Six, at their Summit meeting in The Hague in December 1969, agreed in principle to the creation of a full economic and monetary union, and appointed a high-level committee (the so-called "Werner Committee") to work out a concrete programme of action.

The Werner Committee's recommendations have not yet been adopted in detail, though its principal objectives have been confirmed by the Community's Council of Ministers.

The realisation of economic and monetary union, as recommended in the Werner Report, involves three kinds of measures, each introduced in stages: monetary union, tax harmonisation, and central community control over national budgets. It envisages a three-stage programme, with each stage lasting about three years, so that the whole plan is designed to be brought into operation by 1978-80.

In the monetary field in the first stage the interest and credit policy of each central bank is increasingly brought under common Community 'surveillance and permitted margins of variations between exchange grates are reduced or eliminated. In the second stage exchange rates are made immutable and "autonomous parity adjustments" are totally excluded. In the third stage the individual central banks are abolished altogether, or reduced to

the status of the old colonial "Currency Boards" without any credit-creating power.[1]

In the field of tax harmonisation it is envisaged that each country's system should be increasingly aligned to that of other countries, and that there should be "fiscal standardisation" to permit the complete abolition of fiscal frontiers, which means not only identical/orww but also identical *rates* of taxation, particularly in regard to the value added tax and excise duties.

In the field of budgetary control the Werner Report says "the essential elements of the whole of the public budgets, and in particular variations in their volume, the size of balances and the methods of financing or utilising them, will be decided at the Community level".

What is *not* envisaged is that the main responsibility for public expenditure and taxation should be transferred from the national Governments to the Community. Each member country will continue to be responsible for raising the revenue for its own expenditure (apart from the special taxes which are paid to finance the Community's own budget but which will remain a relatively small proportion of total public expenditure and mainly serve the purposes of the Agricultural Fund and other development aid).

And herein lies the basic contradiction in the whole plan. For the Community also envisages that the scale of provision of public services (such as the social services) should be "harmonised"—i.e., that each country should provide such benefits on the same scale as the others and be responsible for financing them by taxation raised from its own citizens. This clearly cannot be done with *equal* rates of taxation unless all Community members are equally prosperous, and increase their rate of prosperity at the same rate as other members. Otherwise the taxation of the less prosperous and/or the slower-growing countries is bound to be higher (or rise faster) than that of the more prosperous (or faster-growing) areas.[2]

[1] Different currencies (marks, francs, etc.) might be nominally retained so long as each currency has always a ioo per cent, backing in terms of the Community's reserve currency.

[2] A further reason for differences in the burden of taxation necessary to provide a given level of service lies in differences in demographic structure—e.g. some countries have a larger proportion of pensioners or schoolchildren than others.

The Community will control each member country's fiscal balance—i.e. it will ensure that each country will raise enough in taxation to prevent it from getting into imbalance with other members on account of its fiscal deficit. To ensure this the taxes in the slow growing areas are bound to be increased faster; this in itself will generate a vicious circle, since with rising taxation they become less competitive and fall behind even more, thereby necessitating higher social expenditures (on unemployment benefits, etc.) and more restrictive fiscal policies.[1] A system on these lines would create rapidly growing inequalities between the different countries, and is bound to break down in a relatively short time.[2]

This is only another way of saying that the objective of a full monetary and economic union is unattainable without a political union; and the latter pre-supposes fiscal *integration,* and not just fiscal *harmonisation.* It requires the creation of a Community Government and Parliament which takes over the responsibility for at least the major part of the expenditure now provided by national governments and finances it by taxes raised at uniform rates throughout the Community. With an integrated system of this kind, the prosperous areas automatically subsidise the poorer areas; and the areas whose exports are declining obtain automatic relief by paying in less, and receiving more, from the central Exchequer. The cumulative tendencies to progress and decline are thus held in check by a "built-in" fiscal stabiliser which makes the "surplus" areas provide automatic fiscal aid to the "deficit" areas.

Even so, there is need for special regional policies—such as the U.K. differential grants and subsidies to the development areas— to alleviate the problems of growing regional inequalities. The need for the latter is recognised (in a vague way) in the Werner Report, which mentioned "community measures which should

[1] It is for this reason that in most countries it has been found necessary to transfer a rising proportion of social expenditure (on poor relief, education, roads etc.) from local authorities to the Central)Government, and to supplement an increasing proportion of local tax revenues by grants from the Centre (such as the rate-equalisation grants in the U.K.).

[2] To imagine the consequences one should ask what would happen if the inhabitants of each county in the U.K. were required to finance all their social expenditure by local taxes. Living in Cumberland would be enormously penalised; living in Surrey would be a tax haven.

primarily concern regional policy and employment policy" and whose "realization would be facilitated by an increase in financial intervention at the Community level". What the Report fails to recognise is that the very existence of a central system of taxation and expenditure is a far more powerful instrument for dispensing "regional aid" than anything that special "financial intervention" to development areas is capable of providing.

The Community's present plan on the other hand is like the house which "divided against itself cannot stand". Monetary union and Community control over budgets will prevent a member country from pursuing full employment policies on its own— from taking steps to offset any sharp decline in the level of its production and employment, but without the benefit of a strong Community government which would shield its inhabitants from its worst consequences.

Some day the nations of Europe may be ready to merge their national identities and create a new European nation—the United States of Europe. If and when they do, a European Government will take over all the functions which the Federal government now provides in the U.S., or in Canada or Australia. This will *involve* the creation of a "full economic and monetary union". But it is a dangerous error to believe that monetary and economic union can *precede* a political union or that it will act (in the words of the Werner Report) "as a leaven for the evolvement of a political union which in the long run it will in any case be unable to do without". For if the creation of a monetary union and Community control over national budgets generates pressures which lead to a breakdown of the whole system it will prevent the development of a political union, not promote it.

But it would also be dangerous to dismiss the Werner Report on the ground that it is not likely to be implemented, particularly if Britain is inside the Community and will have a voice in deciding what happens. For the problems that led to The Hague decisions and to the Werner Report are genuine enough: the framework of institutions and arrangements which make up the present European Community do not constitute a viable system. The Community must either go forward towards full integration *{via* a political union) or else relax the rigidity of its present

arrangements, particularly in regard to agriculture and exchange rates. And it would be hopeless for Britain to join the Community not knowing whether it wishes to move in the one direction or the other.

APPENDIX I

THE EFFECTS OF THE COMMON MARKET ON THE TRADE BETWEEN MEMBER COUNTRIES

The recent O.E.C.D. study referred to in the text[1] makes it possible to examine the effects of the creation of the Common Market on the trade of member countries in relation to each other in much greater detail. This analysis refers to engineering goods only (metal manufacture, electrical and non-electrical machinery, transport equipment and precision instruments) which accounted for 58 per cent of total U.K. exports of manufactures in 1962-3; and it relates to the composition of each country's trade, both in its domestic market and in other E.E.C. markets in the years 1962-3 and 1965-8. It must be borne in mind that while the Common Market has been in existence throughout the whole of this period, the full removal of duties between members only came into effect at the end of the period. The results therefore may not show the full effects of the Customs Union on trade relationships.

The results of the analysis are summarised in the Table which shows for each of the two periods the share of each country's production (i) in its own domestic market; (ii) in other E.E.C. countries; (iii) in the E.E.C. as a whole (including the domestic market of each producing country). For comparison, the U.K.'s share of trade has also been included, both in the U.K. market and in E.E.C. markets.

The table shows that each of the E.E.C. countries managed to increase its share of trade in the *other* E.E.C. countries, though the change was a moderate one for all countries with the exception of Italy, and an insignificant one (in percentage terms) in the case of Germany (Germany already had a much greater share of this trade at the beginning of the period than the other countries). Belgium, Luxembourg and France show a loss in their share of

[1] Cf. footnote 1 p. 193 above.

;ET SHARES IN ENGINEERING GOODS OF E.E.C. COUNTRIES AND THE UNITED KINGDOM IN THEIR DOMESTIC MARKETS AND IN E.E.G. MARKETS IN 1962-3 AND 1967-8

Producing Countries	I Domestic Output $ Billion	II Share in Total Consumption in Domestic Markets		III Market Share in Total Consumption in "other" E.E.C. Markets		IV Market Share in Total Consumption in total E.E.C. Market (including Domestic Markets)[1]	
	1962–3	1962–3	1967–8	1962–3	1967–8	1962–3	1967–8
Belgium-Luxembourg	3·0	61·0	52·6	1·3	1·7	5·4	5·1
France	15·0	87·6	84·3	2·2	2·8	26·8	26·8
W. Germany	28·0	90·4	89·2	8·8	9·8	45·5	45·6
Italy	6·4	73·7	75·5	1·3	2·1	10·5	11·6
Netherlands	2·8	50·9	57·2	1·1	1·3	4·4	5·2
Total: E.E.C.	55·2	82·9	80·9	..	..	92·7	93·7
U.K.	21·4	93·4	88·6	..	..	2·0	1·7

trade, both in their domestic trade and in E.E.C. markets as a whole (including their domestic market), while Germany shows only a slight reduction in her domestic market and an unchanged share of trade in E.E.C. as a whole. Italy and the Netherlands on the other hand increased their share both in their own markets and in other E.E.C. markets; in the case of Italy, the increase was substantial in other E.E.C. markets and a moderate one in her own market, while the Netherlands, on the contrary, showed a substantial increase in her share in her domestic market and only a moderate gain in other E.E.C. markets.[1] The U.K. showed a reduction in her (initially small) share of 2 per cent, of trade to 1'7 per cent, but this loss was appreciably smaller than her loss in the rest of the world market in the same period (including all "domestic" markets other than the U.K.) which was from 2-7 to 2-1 per cent.[2] * * * * * However, the U.K. producers' share in the total world consumption of engineering products (including the huge internal market of the U.S.) was in 1967-8 still 25 per cent, higher in the world outside E.E.C. than in E.E.C. markets.

Three main conclusions emerge from these figures. The first is that while the creation of the Common Market involved some diversion of E.E.C. consumption from non-E.E.C. producers to E.E.C. producers, the extent of this diversion was remarkably small. E.E.C. producers supplied 92-7 per cent, of total E.E.C. consumption in 1962-3 and 93-7 per cent, in 1967-8; a net diversion of 1 per cent, in favour of E.E.C. producers.[8]

The second conclusion is that anything like "economic integration" in the E.E.C. is still a very long way off. In a truly integrated economy—in a "single home market" which the White Paper holds out in prospect—one would expect that the share of each country's producers in the total consumption of its own area is not

[1] In relation to the three others, both Italy and the Netherlands were "developing" or "industrialising" countries—with the Netherlands more in the "import-substitu tion" phase (hence the higher rate of gain in her *domestic* market) and Italy in the "early exportive" phase.

* litis latter figure, not shown in table, is derived from Tables *a* and 6 of the O.E.G.D. paper.

*This is in seeming contradiction to the results of Professor Truman's study (*The European Economic Community: Trade Creation and Trade Diversion,* Yale Economic Essays, Spring 1969) according to which there was no net diversion at all in favour of Community producers as a result of the Common Market. This study however makes a ten-year comparison, 1958-68, and relates to the trade in manufactures as a whole.

very different from its share in the markets of other producers— apart from differences due to transport costs (which cannot, in themselves, be very important) there is no reason why say, German buyers should buy German-made products in any higher proportion than other E.E.C. buyers. Yet after ten years of E.E.C.'s existence, each country's producers still had an enormously higher share in their *own* domestic market than in the rest of the Community. In 1967-8 German producers supplied 89-9 per cent, of the German market but only 9-8 per cent, of other E.E.C. markets; French producers supplied 84-3 per cent, of the French market but only 2'8 per cent, of other E.E.C. markets; Italian producers supplied 75-5 per cent, of the Italian market but only 2-1 per cent, of other E.E.C. markets. The degree of Germany's "self-sufficiency" in engineering goods at 89-2 per cent, was slightly higher than that of the U.K. in the same year—despite the fact that Germany was part of a Community which produced engineering products of more than twice the value of German output. To appreciate the significance of these figures they should be seen in the light of analogous estimates concerning the inter-state trade of a truly integrated economy, such as the United States. For the year 1963, and for the same group of engineering products as are covered in the O.E.C.D. study, producers in the state of Michigan accounted for 42 *3 per cent, of the total consumption of such goods in Michigan and 24.3 per cent of other states of the U.S.A.; producers in the state of New York accounted for 20-1 per cent, of the New York market and 9-7 per cent of other U.S. markets.[1]

The third conclusion is that though the U.K. performed relatively better inside the Common Market than outside (in the sense that the loss in her share of trade was proportionately smaller) her share in the E.E.C. market is very small—the same as that of Belgium-Luxembourg, which only had one-seventh of U.K. output. This also means that the potentialities of the E.E.C. market for the U.K. are very large *provided only that U.K. products are competitive with other Community producers.* The case against joining the Common Market is.that, when account is taken of *all* the consequences, it is likely to make the U.K. less, rather than more

[1] 1 am indebted for these estimates to Miss Karen Polenske of the Regional Economic Research Project of Harvard University.

competitive than she is outside it. But if this were not so—if we could, by waving a magic wand, attain a large initial cut in our efficiency wages, or else obtain terms that make this unnecessary —there is plenty of scope for increased trade in the Common Market. This is best seen in a comparison with Germany which is a large producer of a comprehensive range of engineering products, just like the U.K. is, but with a total output which is 50 per cent higher in value terms. Germany supplied in 1967-8 9-8 per cent of the Community markets outside Germany whilst the U.K. supplied 2-4 per cent.[1] If this market were shared between the two countries in equal proportion to their respective outputs, the U.K. share would be 4-9 per cent, instead of 2-4 per cent., while Germany's share would be 7*3 instead of 9-8 per cent. There is a great deal to be gained therefore from increased competitiveness —though for reasons explained, this is unlikely to come about as a result of entering the Common Market on the terms that are likely to be offered to us.

APPENDIX 11

THE COMMUNITY'S BUDGET

The Community's expenditure on the agricultural fund increased at an alarming rate from £205 million in 1966-7 to £950 million in 1968-9 and £1,085 million in the calendar year 1970, an annual rate of increase of £250 million a year. For 1971, the latest estimate of the Commission (as of 1 March 1971) envisages an expenditure of £1,450 million of which £350 million is in respect of past commitments and £1,100 million in respect of current liabilities.[2]

[1] This relates to E.E.C. markets excluding Germany. The figure of 1-7 per cent, referred to earlier and shown in table relates to the *total* E.E.C. market including Germany.'

* The accumulated backlog in respect of past commitments (payable to member Governments) amounted to £980 million as of 1 January 1971 of which only £350 million is expected to be paid in the current year, the rest carried forward. These backlogs arose because the expenditure on market intervention and export restitution were undertaken by member governments, with the right of subsequent re-imburse- ment by the agricultural fund. Since 1970, however, a new system is in operation by which the Community makes direct re-imbursements to individual traders, so that it is hoped to avoid further accumulation of "backlogs" in the future.

Practically the whole of this increase represented expenditure out of the "guarantee fund"—on market intervention and export restitution—in other words, on maintaining prices in the face of growing surpluses, particularly of wheat, dairy products, fats and sugar, on which the bulk of expenditure was spent.[1] Six-sevenths of the total expenditure in recent years has been on price support and only the remaining one-seventh on the "guidance section", i.e., on reforming the structure of agriculture.

However, the Commission hoped that with the adoption of the Mansholt Plan this situation would be changed. Expenditure on structural reform (under the so-called "guidance section") was envisaged to rise from the level of £119 million a year in the years 1967-70 to £260 million in 1971 and £575 million in 1975.[2] At the same time the Commission envisaged that, as a result of structural improvements and other factors, expenditure under the "guarantee section" will be contained at the level of around £900-£1,000 million a year up to 1975 and afterwards reduced.

But whether the Mansholt Plan is adopted or not there is no mechanism to ensure that the expenditure on market intervention will be contained at any particular level, unless the common agricultural *prices* are progressively reduced. The Mansholt Plan, even though it envisages taking a certain amount of land out of cultivation, is bound to increase the efficiency of agriculture (by consolidating farms into larger units, etc.) and this would tend to raise surpluses further, not reduce them. So far too, expenditure under the "guarantee section", which is an open-ended commitment, has risen in almost every year faster than was envisaged: for 1968-9, for example, the liability incurred was £831 million as against a forecast of £572 million.[3]

The Community's expenditure has so far been financed by contributions from the budgets of member states according to a

[1] Table I of the report by the Atlantic Institute (referred to on p. 198) gives details of the cost of market support for the various commodities in different years.

[2] See Cmnd. 4289, Table C. This plan appears however to be shelved for the present and current authorisations only provide a constant £119 million expenditure under the "guidance section" for the three years 1971-3, the same as in previous years.

[3] Cf. Cmnd. 4289, para 16. The exception appears to be 1970 when market intervention on dairy products (chiefly butter) turned out to be lower than expected. It is too early to say however whether this signifies any change in trends.

certain key which was revised each year. As a result, each member government had to provide its agreed share of total outlay (which depended on the scale of market intervention). This was clearly not a tenable situation and was the main reason for the introduction of the new financial arrangements by which the Community provides for its "own resources" by obtaining the proceeds of certain taxes. This system is to be brought into operation in stages in the years 1971-5, with certain "correctives" (designed to prevent the share of any one country's contribution from rising too fast) up to 1978.

The new system sets both a certain minimum and maximum to the contribution raised in each country. Each country hands over the proceeds of its import levies and customs duties (less 10 per cent, to cover the costs of collection) in any case. In addition it is liable to hand over part of the proceeds of the value added tax (depending on financial requirement) up to a tax of 1 per cent, on value added. The White Paper estimates that in the late 1970s this would imply a U.K. contribution of £670 million at the maximum and £430 at the minimum. Since the U.K. would collect relatively more in agricultural import levies (and probably also in customs duties) than the other members of the Community its share in Community finance would be higher than its share in the national income, at present levels of G.N.P. the U.K. would account for less than 20 per cent, of the G.N.P. of the larger community, while its liability would be more like 27 per cent.[1] By the late 1970s, the U.K.'s share in the total G.N.P. might be 16-18 per cent., and its share of the Community yield of these taxes might be 22-5 per cent.

On the latter basis, the minimum U.K. liability implies a total Community revenue of around £1,600 million and its maximum liability a total revenue of £2,900 million. This revenue serves primarily to finance the Agricultural Fund, and other purposes only in so far as there is a surplus of revenue over expenditure by the Fund. It is not clear what is to happen if the Community expenditure comes to exceed the maximum revenue under the new

[1] The latter figure assumes a value added tax of comparable coverage in all countries and makes some allowance for the fact that the share of personal consumption in the G.N.P. is higher in Britain than in the Six. All figures relate to an enlarged Community including Britain but without taking into account the entry of other countries.

arrangements—presumably the i per cent, limit on the value- added tax would be raised.

Current expenditure plans do not extend beyond 1973, and envisage a budget of £1,170 million for that year (£70 million more than for 1971) without provision for increased expenditure for the Mansholt Plan. However this is no more than guesswork, since actual expenditure incurred will depend entirely on the size of the surpluses that will accrue. Since the Community is unable, for political reasons, to agree on any reduction in the prices of surplus commodities (if anything, prices are likely to be further increased) it would be prudent to reckon that expenditures under the "guarantee section" will continue to rise at least at half the rate of the previous four years. This means that by 1977 expenditure under the "guarantee section" might be around £2,000 million with total expenditure around £2,200-£2,6oo million according to whether the Mansholt Plan is adopted or not. Britain, according to Mr Rippon's statement (*Hansard*, 16 December, 1970, col. 1,355), suggested to the Community that its budget for 1977 should be limited to £1,875 million. Whether the Community will be ready to accept the idea of such a ceiling or not, it would be reasonable to assume that by the time Britain makes its full contribution to the Community budget, expenditures will be at a level at which the contribution of member countries will be not far short of their present maximum commitments. (Excluding Britain's contribution, the current total of agricultural expenditures is already considerably in excess of the full yield from import levies and customs duties, which is around £930 million.)

How much benefit the U.K. will derive from that expenditure has not anywhere been analysed. The White Paper put it at £50- £100 million, but it did not specify whether these sums would arise under the "guarantee section" or the "guidance section". It is difficult to see how the U.K. could make claims on the Community Fund undtr the "guarantee section" until a situation is reached where its p^pduction of cereals, meat or butter exceeds its domestic consumption—which is very far from the case at present. Again, it is difficult to see on what grounds the U.K. could claim under the "guidance section" since the projected expenditure

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under the Mansholt Plan on consolidation of farms into larger units and compensation to retired farmers or for retraining, etc. is of a kind which would not apply to the bulk of British agriculture. It would be inconsistent with the Community's system to bargain in terms of a certain "net contribution"—i.e., to make a certain minimum receipt a condition for a certain gross contribution. Indeed, as Mr. Rippon emphasised at the recent Brussels ministerial meeting on 2 February 1971, Britain fully accepts the existing Community arrangements concerning both the finance of the Fund and the purposes of expenditures out of the Fund, at the end of the transitional period.

The current negotiations therefore are only concerned with the length of the transitional period, the size of the initial contribution and the rate of build-up during the transitional period. The current British proposal is that the initial contribution should only be 3 per cent, of total expenditure, rising gradually to 13-15 per cent, by 1978 and attaining the full level of 22-25 per cent, only in 1981.

The French position (which is shared in a greater or lesser degree by the other members of the Community) is that the need for a transitional period for the adaptation of tariffs and the adjustment of agricultural prices does not in itself justify such a postponement of financial liability. The U.K.'s balance of payments is exceptionally strong at present by historical standards, and there is no reason why it should improve in the course of the adjustment period—indeed, the deterioration of the terms of trade and the adverse impact effect on our industrial exports and imports would suggest in the initial phases at any rate that the balance of payments is likely to deteriorate. Hence the very insistence on a postponement of the assumption of financial liabilities calls into question the sincerity of the Government's intentions of adhering to its obligations under the system at the end of the transitional period. \

Such suspicion is probably unjustified, but there can be little doubt (in the light of Mr. Rippon's statement in the House of Commons during the Common Market debate)[1] that the Government hopes that by the early 1980s either the situation concerning

[1] *Hansard*, 20 January 1971, cob. 1082-3.

British agriculture will be different from what it is now or else the Community's current agricultural price policies could be so changed after 1973 (when Britain expects to enter as a full member and will have a voice in the decisions concerning agricultural prices etc.) so that the net benefit the U.K. will derive from the Community's expenditure will be very much larger in relation to her contribution than it would be now. How far such expectations are justified will depend *inter alia* on whether the Community's decisions on these matters will be taken under a majority rule or under a unanimity rule. Under a unanimity rule, the U.K. could prevent by its veto any further rise in E.E.C. agricultural prices but it would be unable to effect any reduction in the face of growing surpluses; under the majority rule, it is quite possible that the interests of a sufficient number of countries will operate in favour of a progressive reduction of prices and a gradual elimination of agricultural surpluses.

APPENDIX III

THE RESOURCE COST OF ENTRY

The cost of entry into the Common Market will be made up of a number of elements: (i) the net contribution to the Community budget; (ii) the higher cost of food imports from E.E.C. countries; (iii) the cost of financing the additional capital outflow; (iv) finally, the additional cost, in terms of domestic resources, of adjusting the balance of payments for the above factors, as well as for the deterioration in our balance of exports and imports of manufactured goods (resulting from tariffs and preference changes).

(i) With regard to the contribution to the Community's budget, it is best to show the position in the first year following upon the completion of transitional arrangements—which, depending on negotiation, might be any of the years between 1978 and 1981—àince this alone shows the ultimate burden to which the transitional arrangements must lead. Britain has already conceded that it accepts in full the commitment under the new financial arrangements according to which each country

pays into the Community the proceeds of certain taxes, irrespective of what this represents as a share of the Community's total expenditure, and how it relates to the payments received by a particular country from the agricultural fund. The White Paper estimated that Britain's gross contribution under these arrangements will be between £430 million at the minimum and £670 million at the maximum, and its net contribution between £330 million and £620 million. We have already given reasons why the actual figure is likely to be nearer the upper, rather than the lower, limit of these estimates.

(ii) For the additional cost of food bought from E.E.C. farmers, the White Paper gives a wide range of different estimates: all the *low* estimates depend however on the assumption that the British consumer will react to higher food prices by a "tightening of belts"—i.e., by a relatively large reduction of food consumption. We regard this as *a priori* unlikely; on the basis of a smaller change of consumption, and a "middle production response" of British agriculture, £200 million appeared to be the best estimate to take for this item.

(iii) With regard to net capital outflow, the White Paper refrained from any quantitative estimate beyond saying that it "must be expected in a typical year to involve a sizeable cost to the United Kingdom balance of payments" (para. 94). It would indeed be pretty useless to make any estimate of its magnitude: its size may vary within very wide limits depending on the relative profitability of investment in Britain and in other E.E.C. countries, and on how far we shall succeed in matching long-term lending with short-term borrowing (as we have done in the past). It is also difficult to imagine any British government raising extra resources through taxation or Jay further deflation for the sake of providing finance for additional private investment on the Continent. We have therefore made *no* allowance for the cost of this item in our estimate, or for other charges of a capital nature as would arise, for example, if we were required to fund and amortise the sterling balances.

(iv) Finally, there is the additional cost in terms of resources, of adjusting the balance of payments—the cost of increasing our exports and/or reducing our imports sufficiently so as to pay for

the above items. The White Paper omitted this entirely from the calculation. The size of this additional resource cost will vary with the method chosen for adjusting the balance of payments— i.e., whether it is by deflation or devaluation. With deflation, the method relies largely on the reduction of imports achieved through a reduction of domestic incomes and employment; this would involve a loss of output that is likely to be many times as large as the required balance-of-payments adjustment. With devaluation, this extra resource-cost is very much smaller—just how great it is, depends on a large number of factors such as the response of exports to changes in prices and in profits, the saving in imports resulting from higher import prices, and the extent to which the prices of imports fail to rise by the full extent of devaluation. In the latter respect we shall be in a worse position than at the time of the 1967 devaluation, since under E.E.C. rules food prices are bound to rise by the full extent of the exchange rate adjustment.

On the basis of a complex set of assumptions which can be largely justified by the experience of the 1967 devaluation but which it would be too tedious to set out in detail, this extra resource cost can be put at 33J per cent, of the balance-of-payments adjustment required on account of the budgetary contribution and the higher food prices paid on imports from E.E.C. countries, and something of the order of 16-5 per cent, of the deterioration in the export-import balance of manufactured goods (which does not in itself represent a “resource cost”). On this basis the net additional resource cost of the balance-of- payments adjustment can be put at ^205-^340 million and the total resource cost ^735-^1,160 million (without making allowance for capital movements).

But this is not the end of the story. As a result of adopting the Community’s price system and of “harmonising” with the Community’s tax system there will be a gain to farmers, to distributors and processors of fqpd and to industrial profits. Farmers will gain £300 million (the market value of present farm output will rise by £450 million, but they will lose £150 million in subsidies); distributors will gain (in higher absolute margins on both imported and home produced food) £300; and as a result of the

adoption of V.A.T. at the rates prevailing in the Community, and the adjustment in insurance contributions, there will be an appreciable net shift in the burden of taxation in favour of higher incomes. The industrial wage-earner will thus be made to pay far more than his proper share of the total resource cost of adjustment. Whereas this total resource cost (at the higher figure) would amount to only 5 per cent, of the current total wage and salary bill, and to 3 per cent, of G.N.P., the reduction in industrial real wages would be more like 10 per cent: the rise in food prices alone would cause a cut of 5 per cent., and the introduction of V.A.T. and of higher social insurance contributions, after allowing for all compensating changes, a further 5 per cent.

THE COMMON MARKET — A FINAL ASSESSMENT[1]

1971 will mark an important watershed in British constitutional history. For the first time since 1689 the House of Commons will vote in favour of a major change in Britain's constitution to which the electorate is definitely opposed. It is also evident, though less clearly, that 1971 will mark an important watershed in the history of the European Economic Community—and for reasons unconnected with Britain's entry. It will be the year in which 10 years of seemingly uninterrupted progress towards European unity came to a standstill and in which, for the first time since the signing of the Treaty of Rome, the drive towards unification and integration was put into reverse.

It is important to be clear how all this happened. The members of the E.E.C. succeeded, in the course of the 1960s, in putting all their stated policy objectives into operation according to plan. Internal industrial tariffs were wholly abandoned, a common external tariff was agreed on and brought into operation. The Common Agricultural Policy, ensuring common prices, a common system of market intervention and complete freedom of movement of goods across frontiers was brought into being and extended to all major agricultural commodities. Finally, the Brussels Commission succeeded in establishing itself, and putting into effect numerous acts of "harmonisation", large and small, extending from the shape of milk bottles to the commitment to adopt a value added tax.

However, the currency re-alignments of 1969—the devaluation of the franc and the revaluation of the mark—brought home the incongruity of the existing monetary and economic arrangements. Freedom of trade in agricultural goods had to be temporarily suspended, as neither France nor Germany was prepared to adjust

[1] Published in the *New Statesman,* 22 October 1971.

its internal agricultural prices *pari passu* with the change in currency parities. What was shown was the impossibility of creating a truly "integrated" economic area if individual member countries pursue separate monetary and fiscal policies or separate wages policies. Given the freedom to vary exchange rates, the terms of competition between the different regions can be altered in the same way as if each member country remained free to levy flat-rate import duties or pay out flat-rate export subsidies on its frontiers, and to do so at a stroke.

After the experience of the exchange crises of the summer and autumn of 1969, a summit meeting was called in The Hague in December (on the initiative of the French President) which represented the high watermark in the drive for European integration. This meeting agreed that a full "economic and monetary union" should be created, with a single Community currency, and asked for a detailed plan to be worked out for its implementation by stages, according to a fixed timetable.

The resulting "Werner Report" brought the inherent conflict between Europeanism and national sovereignty into the open. Community control over national fiscal policies, *à la* Werner—without a central parliament, and a central taxing and spending authority—would mean the worst of both worlds. It would prevent the individual countries from pursuing policies of economic management, yet it would not put in their place a federal government to perform these functions.

The first *dénouement* came in February when decisions had to be taken on the Werner Report. Clearly the governments were not prepared to surrender control over national monetary or budgetary policies. They agreed to have further consultations, but without any commitment to proceed further with the plan. Then came the Schiller plan of "joint floating" of the Community currencies against the dollar, which the French decisively rejected, both in April and May, and after the Nixon crisis in August. The different countries of the E.E.C. now follow widely different currency policies, some floating together, others floating separately, yet others with dual exchange rates, all of which makes mockery of economic integration in general and of the Common Agricultural Policy in particular.

The Germans now raise border taxes on their imports from France (revised week by week) and the German Minister of Agriculture has already announced that Germany will not be prepared to abolish these even if currencies come to be re-pegged. This puts the whole conception of supporting agriculture by means of a Community fund into jeopardy. If each country's internal agricultural market is isolated from the others, what is the justification for the food-deficient countries paying vast subventions to the food-surplus countries? Indeed, there are influential voices in Germany (including that of Dr. Dahrendorf, a member of the Brussels Commission) which call into question the need, or the justification, for having a Common Agricultural Policy at all. In other respects too, there are voices critical of the working of the E.E.C. institutions—the "harmonisation mania", as one of Dahrendorf's articles put it—which makes it increasingly probable that the "Second Europe" of the 1970s will develop very differently from the "First Europe" of the Rome Treaty, and will be something more akin to the present E.F.T.A. than to the present or projected E.E.C.

If the above analysis is correct—and Britain's accession will no doubt strengthen these tendencies, not weaken them—joining the Market will not make the great difference to Britain's economic prospects which either its opponents fear or its advocates hope for. There will be *no* European monetary or economic integration, or political federation : we shall *not* lose our sovereignty, or our freedom to introduce frequent mini-budgets without prior approval by Brussels.

Should one conclude therefore that this is largely a sham battle, the issue of which will not, in the end, make a great deal of difference? Unfortunately this is not so, largely on account of Mr. Heath, and the Tory philosophy he represents. If you believe that Britain's "decadence" in the present century is largely the result of feather-bedding, and our salvation lies in a return- to the bracing atmosphere of the Victorian age—making the rewards of success so much greater and the penalties of failure so much more severe—there is no better way of bringing this about than by a system of high food prices, heavy indirect taxes on articles of mass consumption and reliance on universal employers' contributions

(the incidence of which falls *wholly* on wage and salary earners) for financing social expenditure. As war-time experience has shown, keeping the price of necessities low is a far more potent method for reducing economic inequalities than altering the distribution of incomes through direct taxation. Equally, there is no better way of changing the distribution of incomes in favour of the middle and upper classes than to raise the price of things like food or rents, on which the poor man necessarily spends a much greater proportion of his resources than the rich man.

Hence the determination in the Selsdon programme to introduce V.A.T. and to replace agricultural subsidies by import levies irrespective of entry into the Market. Hence also the drive to raise rents and to substitute means-tested for universal benefits. While all these things *could* be done without the Market, doing them as part of a process of going into Europe has obvious advantages, not least of which is that it would be difficult for a future Labour government to go back on them if this involved "de^harmonising" with Europe.

Moreover, by entering Europe, the change in distribution of *incomes* can be combined with a change in the distribution of *power*. The kind of situation which happened at Fords last winter when, after a prolonged strike, the company was forced to grant practically all the unions' demands, could not happen if Fords could equally well supply their U.K. distributors with German- made cars.

When the Labour Party adopted the slogan "no entry on Tory terms" they spoke better than they knew. With the trends now unfolding in Europe, the chances are that a Labour government could bring us into the Market without any great sacrifice either to our balance of payments or to the British way of life. But with a Tory government in power, there is little chance of this precisely because it is the reactionary aspects of the "harmonisation" process which provide for them one of the main attractions of entering Europe, *i*

THE NEMESIS OF FREE TRADE[1]

LET me begin with a quotation:

> "I was brought up, like most Englishmen, to respect Free Trade not only as an economic doctrine which a rational and instructed person could not doubt but almost as a part of the moral law. I regarded departures from it as being at the same time an imbecility and an outrage. I thought England's un- shakeable Free Trade convictions, maintained for nearly a hundred years, to be both the explanation before man and the justification before heaven of her economic supremacy. As lately as 1923 I was writing that Free Trade was based on fundamental truths which, stated with their due qualifications, no one can dispute who is capable of understanding the meaning of words."

This was not said by John Stuart Mill, nor Alfred Marshall, nor even by a great Liberal statesman like Asquith. It forms the introductory paragraph to two articles written by J. M. Keynes entitled "National Self-Sufficiency" which appeared in the *New Statesman and Nation* in July, 1933—written, that is to say, nearly two years *after* Britain's departure from the gold standard. Keynes advocated a "revenue tariff" two years earlier as an *alternative* to going off the gold standard and as a way of re-expanding the economy in a state of depression. But in these two articles he looked at the issue of international trade from a more long-term point of view, and asked himself whether the advantages of the

[1] Originally a public lecture delivered at the University of Leeds, 21 March 1977. I am indebted to Mr. Robert Skidelsky for drawing my attention to the passages quoted in the speeches of Joseph Chamberlain and Herbert Asquith, which were taken from Charles W. Boyd (ed.), *Mr. Chamberlain's Speeches*, ii, 1914, pp. 120-372; *Speeches by the Earl of Oxford and Asquith*, 1927, pp. 45-81.

international division of labour or specialisation were as great in the twentieth as in the nineteenth century, and whether the case for greater self-sufficiency is not stronger if one takes into account the gains in terms of greater economic stability.

Yet these articles were curiously disappointing—Keynes searched for reasons why free trade failed to deliver the goods but at that point in time did not know how to find them. In particular he failed to come to grips with the two crucial issues of the free trade *versus* protection controversy: the question of the level of *employment* and the rate of economic *growth*. These questions figured prominently in the debate initiated by Joseph Chamber- lain 30 years earlier—in the famous tariff reform campaign of 1903. The issues considered and the arguments displayed in that debate sound curiously familiar to those who listened to or participated in recent discussions on economic policy—with the difference only that the protagonists seem to have changed sides— what was then considered "right-wing" is now considered "left- wing" and *vice-versa*. Perhaps this is too simple, and it is wrong to attach political labels to economic arguments—Joe Chamberlain was, after all a radical who became Conservative in later life. However that may be, many of the points made in Joe Chamber- lain's speeches in 1903-5 (and their whole tone) would be more likely to be heard today from a member of the Tribune group than from a member of the Conservative Party, whilst the arguments of his great opponent, Mr. Asquith (as he then was), are much closer to those advanced by right-wing Conservatives such as Sir Keith Joseph or Mr. Brittan, or the present editor of *The Times*. It is worth therefore recalling some of the things that Chamberlain said, and the counter-arguments that were advanced against them.

(i) His main concern was "to secure *more employment* at fair wages for the working men of this country". He said in 1905 (that is, 30 years before Keynes!) that the "question of *employment* has now become the most important question of our time. Cheap goods, a higher standard of living, higher wages—all these things are contained in the word [1] *employment'*. If my policy gives you more *employment*, the others will be added unto you."

(ii) His second concern was to maintain a satisfactory rate of

growth—not just absolutely, but *relatively* to Britain's competitors.[1]

(in) He explained that the effects of industrial decline are very different on the *manufacturer* and the *worker*. The manufacturer may save himself—he may invest his capital abroad, where profits are higher (because you can operate there on a protected home market). "Yes, the manufacturer may save himself [he could have added 'he might become a multinational']. But it is not for him that I am chiefly concerned. It is for you—the workers—I say to you the loss of employment means more than the loss of capital to any manufacturer. *You cannot live on your investments in a foreign country*. You live on the labour of your hands—and if that labour is taken from you, you have no recourse except perhaps to learn French or German." (This is just what the left-wing opponents of the Common Market have been saying in recent years.)

(iv) The counter-arguments, put forward by Asquith, all centred around the proposition that Britain's difficulties were due to inefficiency and this in turn is due to her stubborn industrial conservatism. Protection would *freeze* inefficiency instead of encouraging the necessary shift in resources. If a trade becomes unprofitable, this is only because *the resources engaged in making it must have more important uses elsewhere*. Chamberlain's reply to this is worth quoting in full:

"I believe that all this is part of the old fallacy about the transfer of employment. ... It is your fault if you do not leave the industry which is failing and join the industry which is rising. Well, sir, it is an admirable theory: it satisfies everything but an empty stomach. Look how easy it is. Your once great trade in sugar refining is gone; all right, try jam. Your iron trade is going; never mind, you can make mousetraps. The cotton trade is threatened; well, what does that matter to you? Suppose you try doll's eyes. . . . But how long is this to go on? Why on earth are you to suppose that the same process which ruined the sugar refining will not in the course of time be applied to jam? And when jam is gone? Then you have to find something else. And believe me, that although the industries of this country are very various, you cannot go on'Tor ever. You cannot go on watching

[1] He was convinced that a *relatively* slow rate of industrial growth constitutes a serious handicap in itself in competition with the industries of faster growing countries.

with indifference the disappearance of your principal industries."

(v) Asquith's next answer was—again it is one that we have encountered frequently in recent years—that Chamberlain made an unpardonable mistake in concentrating on "visible" trade— the trade in commodities, as if this were all that mattered, whereas Britain had a rapidly growing source of "invisible" earnings which paid for a growing share of imports. But Chamberlain replied *"by what kind of export is the import balanced? If we import something which is the equivalent to a pound of labour, a pound of wages*—do we export the equivalent of a pound of wages? Finance, and other invisibles, or earnings from abroad, do not give rise to *home* employment, or not in the same way. Workmen could starve in the midst of unprecedented abundance."

Yet the essence of the anti-ffee-trade case—which was not seen or understood *at all* by Asquith and other free traders—was only dimly perceived by Chamberlain, as is shown by the following passage:

> "When Mr. Cohen preached his doctrine, he believed . . . that while foreign countries would supply us with our foodstuffs and raw materials, we should send them in exchange our manufactures. But that is exactly what we have *not* done. On the contrary, in the period to which I have referred, we are sending less and less of our manufactures to them and they are sending more and more of their manufactures to us."

(This relates to the 1900s, not the 1970s!)

Why is the one kind of trade different from the other? The answer is that manufacturing activities are subject to *increasing returns to scale*—both of a static and dynamic kind—and under these conditions the presumption derived from Ricardo's doctrine of comparative costs—the presumption that free trade secures the best allocation of resources to each and every participant, and that there must be a net gain from trade all round—no longer holds. For under these -conditions it can be demonstrated that free trade may lead to stunted growth, or even impoverishment of some regions (or countries) to the greater benefit of others.

This is a point which Adam Smith—who laid the strongest

emphasis on the benefits of "the division of labour" which depend "on the extent of the market"—certainly did not perceive, though he was well aware of the fact that increasing returns—the reduction in costs resulting from large-scale production—apply to manufacturing industry, and not to agriculture, where diminishing returns prevail.

Ricardo's pamphlet on the influence of the price of corn on the profits of stock—which was as influential in shaping the whole thinking of the nineteenth century as any other pamphlet of that century—was a strong argument *against* protecting *agriculture*. The question of protecting manufactures did not arise, since at that time Britain was pre-eminent in the world as a manufacturing country, and the question of her industries needing protection was not one that anyone considered. On the contrary, the free importation of corn by enlarging the income of foreign producers had a beneficial effect on our exports of manufactures. Hence in the context of Ricardo's theory, and Britain's historical situation, free trade could bring nothing but advantages: (1) lower food prices; (2) lower wages in terms of manufactured goods; (3) higher profits and faster capital accumulation in industry; (4) enlarged markets for British manufactured goods, on account of higher imports. For completion he should have added that free trade may not be *equally* advantageous to foreign countries who, whilst exporting more foodstuffs and raw materials to Britain, may suffer a loss of income through the shrinkage of their *oum* manufacturing activities. Indeed, the arrival of cheap factory-made English goods *did* cause a loss of employment and output of small-scale industry (the artisanate) both in European countries (where it was later offset by large-scale industrialisation brought about by protection) and even more in India and China, where it was not so offset.

But while Ricardo's original pamphlet, and the policy arguments based on it, were perfectly sound, Ricardo's later formulations of the doctrine of "comparative costs" insinuated further assumptions into the argument with the unfortunate consequence that more was claimed for "free trade" than was in fact justified. For in demonstrating, or attempting to demonstrate, that all countries will benefit from trade, irrespective of whether they are high cost or low cost, rich or poor, Ricardo introduced (without

fully realising its importance or consequences) the main neoclassical assumption of "linearity"—the universal assumption of linear-homogeneous production functions or constant returns to scale, i.e. constant costs per unit of output irrespective of how much or how little is produced. It is only under these assumptions that the hypothesis that Portugal will necessarily be made richer by free trade, even though free trade causes Portugal to specialise on the production of wine (i.e. on agriculture, a diminishing returns industry) and England to specialise on the production of cloth, is valid; and under these assumptions there is indeed no case for interference with trade, either on employment grounds or on productivity grounds. Under these assumptions free trade must always be a Good Thing, whether it is one-sided or not.

This formal extension of the theory had highly unfortunate consequences from which we still suffer today. For whilst free trade suited Britain perfectly while it served to enhance the *share of U.K. manufactures in the world market*, and thereby enhanced the rate of growth of our manufacturing industry and of the G.D.P., the reverse was the case when other countries—Germany, France, the United States, Japan, to name only the most important— began to foster their manufacturing industries behind the shelter of protective tariffs. Our continued adherence to free trade meant that a lot of *new* industries—such as chemicals or industries based on electricity—could not be properly established here. As the traditional industries became increasingly unprofitable our savings were increasingly invested abroad. British exports were chased from pillar to post, as one market after another became closed— "whenever we begin to do a trade, the door is slammed in our faces with a whacking tariff" (Chamberlain).

After 25 prosperous years of fast growth (3J per cent.), ending in 1873 we had 40 years of slow growth (1 \ per cent.), the last 14 of which, falling in this century, having been the worst—with productivity declining, G.D.P. stagnant, home investment halved (down to 5 per cent of G.D.P. compared with 15 per cent, in Germany), capital exports reaching unprecedented levels. Net emigration from Great Britain alone (not counting Ireland) was nearly 6 million between 1880 and 1910.

The great Liberal victory of 1906, by reconfirming the

adherence to free trade, made the continuation of economic stagnation certain, from which Britain was relieved only by the First World War. (It is arguable that without the world wars, the present crisis would have been reached 50 years earlier.) After that, things were never quite so bad again until the 1970s. For World War I witnessed a fast ^-industrialisation of Britain, forced by the necessities of war and the boundless energy of Mr. Lloyd George; and after that, some industries—the so-called "key industries", like chemicals and optics, and others, such as the motor industry—remained protected. Then, following one more abortive attempt (by Stanley Baldwin, in 1923) the Tories finally succeeded in introducing a general tariff of 20 per cent, *ad valorem.* on all manufactures (with 30 per cent, in steel and chemicals) in 1932. After that, for a time Britain became the fastest growing country in the world. Over the twenty-three years 1932-55, industrial production grew at a compound rate of 4 per cent, a year—faster than ever before or since.

But since 1968 our *relative performance* has deteriorated more than ever before, and the experience since 1972 has shown that even with a succession of devaluations under a régime of a floating rate, we have not been able to reverse the adverse trends facing us in world trade. These have made for a continued shrinkage of demand for British products. The nemesis of the belief in free trade and in free markets, after a century of failures, haunts us still. Certainly none of the great original advocates of free trade— Cobden in particular—would have thought it possible that the abolition of import restrictions could lead to a shrinkage of industrial production and employment. Under the particular conditions prevailing in the first half, or the first three-quarters, of the nineteenth century they were undoubtedly right. But the great ideological victory of the free traders meant that the arguments continued to be used successfully, and are used still— witness the agitation concerning the great "dynamic benefits" of a home market of 250 millions which preceded our entry into Europe—long after they have ceased to have validity. At the present time, it is German industry, not the British, which derives great benefits from the "home market of 250 million". British industry is threatened with continued shrinkage and progressive decline.

Supposing we had not been ideologically wedded to free trade but had adopted a policy of fostering the growth of our manufacturing industries by much the same methods as those by which Germany, France, the United States and Japan fostered the growth of their industries—that is, mainly by a protective tariff and also by the planned development of basic industrial capacity —what would have happened?

We could not of course have maintained the industrial pre-eminence we enjoyed in the mid-nineteenth century. It was quite inevitable that the techniques of large-scale factory production and of mechanical power should have spread to the rest of Europe and to North America. It was inevitable moreover that the successful latecomers to industrialisation should in some ways have surpassed Britain just because they had the benefit of learning from our experience without the handicap of well-entrenched traditions such as "learning on the job" as against formal technical education.

But I have little doubt that with a protected home market we could have enjoyed much higher growth rates and as a result we would now have much higher living standards and more secure employment. Even a 1 per cent, addition to our annual growth rate in the century following 1873 would have meant that our living standards today would be nearly three times higher than they are.

If we had followed these policies, other industrial countries would not have been able to grow at our expense—or at least not nearly as much. This is particularly true of Germany in the period 1880-1914 and of Japan in the period 1950-75. This does not necessarily imply that total rate of growth of world industrial production would have been lower and not higher as a result of a protectionist policy by Britain.

However that may be, it is useless to speculate on what *might* have happened. Time is irreversible, and even if we made a fresh start tomorrow, thq time lost could never be entirely regained.