January 21, 1960

THE COMMON MARKET - THE PERIOD OF TRANSITION

Opening Remarks of George W. Ball
Partner, Cleary, Gottlieb, Steen and Ball

before the

400th Meeting of the National Industrial Conference Board, Inc.
Hotel Commodore
New York City

If any of you had lived in New York in 1787 and had ordered a load of cordwood from Connecticut, the wagon driver who hauled it would have been stopped at the New York border and made to pay a customs duty. If, at the same time, your wife had purchased some cabbages in New Jersey, the farmer who barged them across the Hudson would have been met with a similar demand for duty. If in those days you had lived in the Commonwealth of Virginia you would have thought twice before patronizing other than your home state merchants; Virginia imposed the same customs duties on goods imported from her sister states as on goods imported from across the sea.

This was the situation among the thirteen small American states struggling for a precarious living on the Eastern littoral of this continent. Under the Articles of Confederation we were on our way towards creating a Balkanized economy. Had the Founding Fathers permitted the states to drift much farther as a loose Confederation, almost certainly the pressures of local self-interest would have hardened the obstacles to the free flow of trade into a rigid tariff system.

But the Founding Fathers - who seem to this nostalgic age so much more perceptive than today's politicians - met this trend head on. They recognized, in the words of Alexander Hamilton, that --

> "An unrestrained intercourse between the States . . . will advance the trade of each . . . not only by the supply of reciprocal wants at home, but for exportation to foreign markets."

And in drafting the Constitution they put an end forever to small discriminatory markets on the soil of the United States.

First, largely at the instance of James Madison, they prohibited any of our States from imposing duties on imports or exports without the consent of Congress. Second, by a delegation to the federal government of such powers as the powers to tax, to coin money and to regulate interstate commerce, they paved the way for a high degree of central control over economic policy. Finally, they created a set of federal institutions to see to the carrying out of all the articles of the Constitution.

I have made this brief reference to our Constitutional history because it has peculiar relevance to the subject that we are discussing today - the European Common Market. In drafting the Treaty of Rome, which serves the Common Market both as a Constitution and a Code of Laws, the Europeans who have brilliantly conceived and patiently promoted the idea of the Common Market quite self-consciously borrowed these principles of our Federal experience.

Creation of Common Market

First, they provided in the Treaty that the Six member countries which comprise the Economic Community must do away with all barriers to the free movement within the Community not only of goods, but also of labor, services and capital. This is to be progressively accomplished over a transition period of 12 to 15 years from January 1, 1958.

The principal obstacles to the free movement of goods are, of course, import quotas and tariffs. Import quotas were in wide operation during the chaotic period after the war, but, with prosperity in Europe, they are definitely on the way out. I'm sure you are all familiar with the steps which the European nations have recently taken to eliminate discrimination against dollar trade; and I can say with confidence that, barring economic disaster, quotas on industrial products will be eliminated well before the end of the transition period not only with respect to trade within the Community but also with respect to trade between the Community countries and the outside world, including the United States.

The Treaty also calls for the progressive elimination of tariffs. Here again, assuming a continuing high level of economic activity, I think it safe to predict that the internal tariffs on the movement of goods within the Community will be eliminated substantially before the end of the transition period.

Even if the Common Market were only a customs union -- which would be the case if the Treaty did no more than provide for the elimination of barriers to the free movement of goods -- the bringing about of that customs union would be bound to create economic dislocations. The Treaty, in fact, is much more than that; it provides not only for the free movement of goods but also of services, labor and capital. And the Member Countries of the Common Market felt that they could not take such a revolutionary step without at the same time undertaking substantial measures of economic integration. This, in turn, meant the development of certain common governmental policies.

Political Content of the Community

As a result they agreed in the Treaty to develop unified policies covering a wide spectrum of governmental decision.

They agreed, for example:

(1) To work towards a common fiscal and monetary policy;

(2) To take measures to equalize the conditions of labor at an increasingly high level and to apply the principle of equal pay for equal work by men and women;

(3) To establish common rules and regulations governing cartels and monopolies;

(4) To adopt a common agricultural policy; and

(5) To undertake a common commercial policy -- according to a precise timetable and with specific goals -- including a common tariff governing imports from the rest of the world.

This is a very large order. Provisions such as these, if fully carried out, would push the Community very far toward economic unification and quite a way toward political unification as well.

Such an ambitious objective could not be accomplished by casual consultation among representatives of the Six governments. It required the creation of institutions which, it is hoped by many Europeans, might become the germinal institutions, the nucleus, of the government of a future United States of Europe.

I shall not attempt here to describe these institutions. I know that Mr. Leonard Tennyson is going to talk with you about them this afternoon. I shall only say that in general they follow the tripartite division of powers with which we are familiar in our own Government. There is an Executive Power lodged in a Commission, a Judicial Power vested in a Court that has final jurisdiction to decide all legal controversy arising under the Treaty, and, finally, a Parliamentary Power entrusted to an Assembly.

The Court and the Assembly serve not only the European Economic Community but also the two other Communities which have been established by the Six member nations -- the European Coal and Steel Community, under which a common market has been established for coal and steel, and the European Atomic Energy Commission (Euratom, as it is called), which establishes and administers a common atomic policy for the Six Nations.

These, then, are the elements of the Common Market --

. . A political agreement looking toward the elimination of all barriers to the movement of goods, labor, services and capital.

. . A provision for common policies covering a broad spectrum of governmental decision.

. . A comprehensive system of institutions to administer this integrated Europe of the Six which the Treaty establishes.

Economic Character of Member States

Obviously a development of such magnitude as the Common Market must have important implications -- not only for Europe but for the whole world, including the United States. Apart from its political meaning and its contribution to strengthening the delicate power balance between the West and East, it certainly has practical implications for American business. It means the creation of a great new mass market. You American business leaders may regard it either as a new menace or a new opportunity, depending on your confidence in your own competitive abilities.

In a moment I shall try to be a little more specific about these practical implications. Before doing so, however, I think it may be helpful to have a brief look at the economic character and dimensions of the Common Market as it appears today.

The Common Market (Chart 1) consists, as you well know, of six countries -- France, West Germany, Italy, and the so-called Benelux countries (Belgium, The Netherlands, and Luxembourg). Together these nations have a land area in Europe that is approximately one-eighth the area of the continental United States (Chart 2). But in addition to the Common Market proper, one must take into account those areas which are associated with it and which, under the terms of the Treaty, have free access for their products to the Common Market (Chart 3). Moreover, negotiations are beginning which may well result in both Greece and Turkey having special arrangement of association.

Even without its associated territories in Africa and elsewhere the Common Market has a population of 165,000,000 -- very nearly equal to that of our country (Chart 4). However, the Gross National Product of the Common Market countries in 1957 -- the last year for which such figures are available -- was only about one-third that of the United States. But, seven years before, their GNP was only one-fourth that of ours -- and on the basis of purchasing power it has been estimated that the figure today may be more nearly one-half than one-third.

The striking fact about the Common Market countries is that their economies have been developing at a much faster rate than our own. In this chart (Chart 5) the yellow lines, which indicate the trend of the index of industrial production for the Common Market countries, show a steadily and steeply rising curve during the last eight years. In contrast, the blue lines, which represent comparable indices for the United States, show substantial fluctuation. This chart begins with the year 1950, since by that time the European countries had more than regained the level of production they had achieved before the war. Consequently, the progress since 1950 can be regarded as real and not merely as making up for war arrearages.

The pattern of development for the indices of industrial production as a whole is echoed by the indices of special industrial sectors. For manufacturing as a whole -- and this differs from industrial production in that it excludes construction -- we find the same phenomenon of a steadily rising curve for the Common Market and a fluctuating curve for the United States. The same general curve is found for basic metals and for metal products (Chart 6). It is also found even in the case of textiles, a relatively volatile industry (Chart 7), and of chemicals, definitely a growth industry.

There is another clear indication from these charts: the economies of the Six countries have been driven by their own internal engine of growth rather than by a response to developments in the United States. You will recall that in the immediate post-war years it was fashionable to say that if the United States were to catch cold, Europe would catch pneumonia. What has happened in 1953 and 1954, and again in 1957 and 1958, as these charts disclose, suggests that this is no longer true. When the United States caught cold in those years, Europe scarcely had the sniffles.

To understand the extraordinary growth of the economy of the Common Market countries, I think it may be useful to look at what might be called the relative measure of effort (Chart 8).

The first half of this chart shows the index of fixed capital formation, using 1953 as 100. The other half shows fixed capital formation as a percentage of Gross National Product. The black lines show the developments for the Common Market countries. The green lines show what happened in the United States.

As you see, taking fixed capital formation as a percentage of GNP, the figures in 1950 for the Common Market countries and the United States were about the same -- approximately 17%, but by 1957 -- the last period for which these figures are available -- the United States was still at the 17% level, while the figure for the Community countries was well over 21%.

The impressive economic growth shown by these charts and the high level of investment maintained in the latter part of the post-war period have both been achieved by the Six countries operating within the hampering environment of restricted national markets. I think it safe to predict that the Common Market will provide a vastly greater economic arena in which these powerful forces of growth can make themselves felt. What may result -- and already we can see beginning signs of it -- is an explosive development comparable to that which the United States experienced with the opening of the West.

Interest for American Companies

Is it any wonder then that American producers are determined to play a part in the development of this new frontier? I need hardly tell you gentlemen that the number of American firms that are now undertaking, or planning to undertake, direct investment in the Common Market is growing every day.

Recently a survey was made of the investment plans of a selected group of American manufacturing firms. This survey disclosed that in the years 1957 and 1958 more than 50% of their total capital expenditures abroad were in Canada and Latin America, while less than 40% were in Europe. But, in 1960, these companies are planning to invest 47% of their total foreign capital expenditures in European countries. Machinery and transportation equipment were the manufacturing industries concentrating most heavily on European operations. In those industries the companies reported that they planned to spend two-thirds of their total 1960 overseas outlays in Europe.

I am convinced that the major impulse for this massive movement of direct investment to Europe lies in the desire of American business to share the fruits of a rapidly expanding economy and to play a part in the exploitation of a great new mass market. At the same time many American industrialists have another reason for seeking sources of production in Europe. They fear that unless they can manufacture in the Community they may well be excluded from the Common Market, for in its operation the Treaty will tend to penalize the manufacturer who relies on exporting from the United States.

Disadvantage of American Producers

This point can be understood when we examine this chart (Chart 9), which shows the overall changes in the tariff level during the transition period of 12 to 15 years.

As I have stated, under the terms of the Treaty, the tariffs that apply to the movement of goods along national lines within the Community -- that is, within the area of the Six countries -- must be reduced to zero by the end of the transition period, or, in other words, by the end of 1969 and not later than the end of 1971. But a different rule applies with respect to tariffs imposed on shipments from outside the Community. The so-called external tariffs of the Community are not to be reduced to zero but are to be progressively increased (or decreased as the case may be), so that they reach a common level by the end of the transition period. This common level --

the common external tariff, as it is called -- is fixed at the arithmetical averages of the tariffs in effect in the different Community countries on January 1, 1957.

I need not labor the implications of this chart. The American producer must realistically face the probability that, as the Common Market comes into being, his exports to the Common Market countries will be subject to tariffs that may be substantially higher than tariffs now in effect, while competing producers within the Common Market will be able to sell to the same customers with no tariffs at all.

Of course, it is not at all certain that the situation will be as serious as many manufacturers presently see it. Already the officials administering the Common Market have shown their desire to work towards a Community tariff policy as liberal as possible with the outside world. They have shown their determination not to let the Common Market become a restrictive trading bloc, but to use it as a force in bringing about a general reduction in trade barriers throughout the world.

Thus, when the first step was taken towards creation of the Common Market on January 1, 1959, the tariff reductions were extended not only to the members of the Common Market, but to all the members of the General Agreement on Tariffs and Trade (the GATT), of which the United States is a member, and it is likely that the reductions in the next step will be similarly extended. Under the new amendments to the Reciprocal Trade

Agreements Act, negotiations are to be undertaken looking toward the progressive reduction on a reciprocal basis of the common external tariff of the Common Market. There is sentiment in the Common Market countries for an additional reduction once this first negotiation is completed -- provided, of course, we and the other major industrial countries outside the Six are prepared to negotiate further on a reciprocal basis.

Nevertheless, American producers who do not have sources of production within the Common Market will undoubtedly find themselves at some trade disadvantage. For that reason American firms have an incentive, over and above the opportunities which the Common Market offers, to extend their operations into the Community in such a way as to achieve an equal footing with other Common Market producers.

You gentlemen, therefore, are going to have to make some hard decisions if you want to establish a position in the Common Market, maintain an existing position or expand it. The nature of the problem which each of your firms will face depends to considerable extent upon the degree to which it has already committed itself, or is prepared to commit itself, to produce in the European Economic Community.

Firms Exporting to One or More Community Countries

Let us take first the case of a firm that has no production facilities in the Common Market but which has an established export trade with one or more Common Market countries. If your product is presently exported to a low tariff country such as Belgium, you may have to pay an increasing tariff as steps are taken toward achieving the arithmetical average. On the other hand, if you are presently exporting to a high tariff country such as France, you may enjoy some reduction in tariff but you will still be at a disadvantage since your competitors within the Common Market will ultimately face no tariff at all.

Firms That Do Not Export to the Community and License Locally

A second case is where you do not export to the Community but license local producers. You must make sure that your licensees are advantageously placed in the Community and adequately equipped with plant, management and financing so that they can serve a market approaching in size our own American market.

If you have licensees in more than one country within the Community you must decide between them. You may arrange for the strongest to take over the whole market. You may even decide to arrange a merger of your licensee firms.

In many cases you will face legal problems of some complexity especially if you seek to terminate licenses and franchises already granted.

Finally, because of the scale of the market, you may decide to abandon your system of licensing and to undertake direct investment.

Firms with Production in Only One Community Country

If your firm produces in only one country in the Community but sells throughout the Community you may discover that more advantageous production sites are available in other Community countries as the Common Market comes into being. The effect of the Common Market will be to abolish discriminatory tax and social policies and, therefore, to make the selection of the country depend to a much greater extent on natural advantages such as raw materials and labor supply.

Firms with More Than One Operation in the Community

If you have more than one plant in the Common Market you may wish to combine production in a single Community plant. Where special problems, such as the habits and tastes of a particular country are involved, it may still be possible to produce various types and specifications of product in one plant to suit those habits and tastes, or alternatively, to have special assembly operations in various countries of the Community.

These are only brief indications of some of the problems which the Common Market raises for American business. If your company is going to make a rational decision regarding its plans for the Common Market it will have to take into account a great number of complex problems which will differ from one firm to another, depending on the nature of the industry and the position of that firm within the industry. Generalizations are not of much value and the best counsel I can give any of you is that you should avail yourself of the most expert advice and make no decisions until you have studied your individual problem with far greater care than you would give to a decision with respect to expansion in the United States market.

The problem is further complicated by the fact that the European Common Market presently consists of only six countries in Western Europe and that seven other nations have brought into being a competing trading area known as the Free Trade Association. You will hear much more of this in the course of the day but it may be useful for me to speak briefly about this controversial question by way of background.

The Free Trade Area

The European Economic Community (the Common Market) was, as you know, not the first European Community. The Coal and Steel Community, comprising the same six nations, has been an operating reality for seven years, and the Six nations of this Community have acquired experience in working together. Nevertheless, when the proposals for a European Common Market were first seriously put forward in 1956, the hope was still expressed that the United Kingdom and certain other European countries might see fit to join.

However, as I cannot too strongly emphasize, the dominant purpose of the Common Market was political. Its founders intended it as a step toward integration, toward unification, ultimately toward the creation of a United States of Europe. Without this deep motivating conviction they would never have gone forward with the Common Market. The member nations would never have taken the great risks of dislocation and disruption that such a revolutionary step implied had it not been for the political drive behind the idea of unification.

For that reason, they insisted that the Treaty provide not merely for the elimination of barriers to trade but that it contain the political content and establish the political institutions that I have described earlier this afternoon.

Not all of the European nations, however, were prepared to embrace such a step toward political unification. The Austrians felt hesitant to do so because of their treaty commitments with the Soviet Union -- and the Austrian Socialist Party was troubled by memories of the Anschluss with Germany -- unification forced by military might. The Swiss felt obliged to reject political involvements because of their historic policy of neutrality, and to some extent this same logic influenced the Swedes. Great Britain, clearly the leader of the nations which abstained from joining the Common Market, was also haunted by historic policies. Great Britain made it quite clear that she would be prepared to participate only in a very limited form of cooperation with the European countries. Certainly she would have no part in even the most limited step toward a political union that involved a derogation of sovereignty.

The late Professor Andre Siegfried once remarked that Great Britain was like a ship moored in European waters but always ready to sail away at a moment's notice. Certainly the British people -- and I do not say this in a critical spirit -- have regarded and continue to regard themselves not as a part of Europe so much as a center of a worldwide Commonwealth of nations.

Yet the fact could not be ignored that the coming into being of the Common Market created for Great Britain and for all of the peripheral countries a serious problem. They could not accept with a happy mien the commercial disadvantages which non-membership in the Common Market might involve.

For that reason Great Britain, even before the signing of the Common Market Treaty, put forth a proposal for a Free Trade Area which would include not only the countries of the Common Market but all the peripheral European nations -- in fact, all of the 17 nations of the Organization for European Economic Cooperation. This Free Trade Area proposal was abandoned when negotiations with the Common Market countries finally broke down in November of last year. But for tactical reasons a new, more limited scheme has now been agreed on by seven of the countries on the periphery of the Common Market, the so-called "Outer Seven" -- the United Kingdom, Sweden, Norway, Denmark, Austria, Switzerland and Portugal. These countries have initiated a Treaty calling for the creation of a Free Trade Association. Internal tariffs would be eliminated throughout the area of the countries joining the Association. The steps toward the reduction of these tariffs would be phased to keep pace with the steps toward the elimination of the internal tariffs within the Common Market.

Clearly, the proponents of the Stockholm Treaty hope that it will keep open a door -- and in fact will generate pressure -- for an ultimate merger of the Common Market and the Free Trade Association, thus finally achieving the Free Trade Area originally proposed by Great Britain.

Difference Between Free Trade Association and Common Market

Like the Free Trade Area, the Free Trade Association is purely a commercial arrangement. It is in no sense a step toward political unification. But there is another point in which it differs significantly from the Common Market. The nations that are members of the Free Trade Association would not be bound to work toward a common external tariff. Each would be free to tailor its own commercial policy toward the outside world so as to gain the maximum national advantage.

I need hardly point out that this would be bound to result in formidable technical and administrative difficulties. Elaborate measures would have to be taken to prevent goods from entering the Area through that country having the lowest external tariff.

But apart from this, the refusal to agree to the principles of a common external tariff makes the problem of ultimately combining the Free Trade Association and the Common Market extremely difficult. In such a combination the Free Trade Area countries would enjoy all the commercial advantages of free access to the Community while shunning the political responsibilities which the Community imposes -- and this would certainly be unpalatable to the supporters of the Common Market. Under a Free Trade Area, Great Britain in particular would stand to gain immense advantages, for she would serve as the nexus of two trading systems, the British Commonwealth and the Free Trade Area.

The implications of this last point can be best seen in relation to the investment decisions of American companies. There is no doubt that were a Free Trade Area to come into being in the form originally proposed by the United Kingdom, a large share of American direct investment now flowing into the Common Market would be directed to the United Kingdom.

Producers in the United Kingdom would enjoy the best of both worlds -- preferential access to the Commonwealth and free access to the Free Trade Area.

The Problem for America

American firms have found the prospect of these competing trading areas a source of confusion and complication. This has also been true of the United States Government. During the entire period of controversy between the proponents of the Free Trade Area and the Common Market, our Government has quite wisely, I believe, assumed a posture of benign neutrality. The encouragement of measures looking toward the political and economic integration of Europe has long been part of our national policy. This policy has been declared not only by successive American Administrations but by the Congress. Quite naturally, therefore, our Government has consistently expressed its support for the European Common Market, just as it expressed support for the Coal and Steel Community which came into being eight years ago.

While I am in no position to speak for the Administration, I think it clear that most Americans would have been happier if other European nations had joined with the Six in the creation of the Common Market. At the same time, our Government is hardly in position to oppose the Free Trade Association so long as it is within the framework of the GATT - the General Agreement on Tariffs and Trade to which all major Free World trading nations subscribe. As it is now written, the Stockholm Treaty which is the organic document of the Free Trade Association should succeed in meeting the GATT requirements.

In recent months many Americans have become concerned by two possibilities. One is that competition between these two trading areas might distort natural trading patterns and even perhaps result in a limited form of economic warfare that could prove politically divisive for the Western alliance. The second is that the two groups might bridge their differences by extending to the Common Market the commercial arrangements embodied in the Free Trade Association, without a corresponding extension of the political obligations contained in the Common Market Treaty. American concern has been aggravated by the disturbing magnitude of our overall balance of payments deficit with the gold outflow that has resulted.

The Paris Meeting

It was in part because of this growing concern that Mr. Douglas Dillon, the Under-Secretary of State for Economic Affairs, arranged to meet last week with a Special Economic Committee, which included representatives of the member states of the Common Market and the Free Trade Association, as well as a representative of the European Economic Commission. The United States made clear at this meeting that America had a very real stake in the shape and nature of the commercial policies developed among the Six and the Seven, and that we could not contemplate with pleasure any arrangements between the members of those groups that might result in unwarranted discrimination against United States products. At the same time, our representatives made clear that the industrialized nations of Europe should play a larger role in providing capital for the underdeveloped nations. Finally, we advocated the creation of a new organization for economic consultation in which the United States and Canada would fully participate.

As a result of this meeting, a committee of four "wise men", including a representative of the United States, has been instructed to draw up the plans for the new organization. Meanwhile, working parties are being appointed to study the problems of co-existence raised by the Common Market and the

Free Trade Association as well as the relationship of those organizations to the multilateral trade principles which are laid down in GATT.

I cannot over-emphasize the importance of the discussions in Paris last week. The decisions reached at the meeting represent, I believe, a new and wise initiative in American policy -- an initiative almost as important, perhaps, as that which produced the Marshall Plan or the North Atlantic Treaty Organization. For the first time our European allies will be meeting regularly with us to discuss our common economic problems on the basis of complete equality. For the first time we shall be working with our allies to achieve the kind of harmony in the area of economic policy that we have long sought to achieve through NATO in the area of defense.

Precisely what may develop from these discussions is hard to tell at the moment. In the long-range interests of the United States, our objective should be not to try to bring the Six and Seven together in a common trading bloc, which might only increase the trade disadvantage of the American producer, but rather to achieve a greater and greater degree of freedom for trade while at the same time encouraging the nations of Europe to extend their existing commercial relationships into broader aspects of economic and political integration.

These general suggestions as to the direction of our national policy may seem of little practical use to you gentlemen who are faced with hard business decisions of trading and investment. But a sense of what our Government is seeking to achieve must necessarily play a part in these decisions. In view of recent developments in the evolution of opinion on both sides of the Atlantic I would not recommend that you make your policies on the assumption that the nations of the Free Trade Association and the Common Market are likely soon to form a common trading area. I think it much more likely that their differences will be resolved by pragmatic solutions to a long series of specific problems and, I sincerely hope, by a greater and greater progress toward trade liberalization among all the nations of the Free World.