

CENTER OF ECONOMIC RESEARCH

LECTURE SERIES

6.

THE TREND TOWARDS
INTEGRATION

By

JAN TINBERGEN

Professor of Mathematical
Economics at the Netherlands School of Economics

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THE CENTER OF ECONOMIC RESEARCH

The Center of Economic Research in Greece was established in the expectation that it would fulfill three functions: (1) Basic research on the structure and behavior of the Greek economy, (2) Scientific programming of resource allocation for economic development, and (3) Technical-economic training of personnel for key positions in government and industry. Its financial resources have been contributed by the Greek Government, the United States Mission in Greece and the Ford and Rockefeller Foundations. The University of California at Berkeley participates in the process of selection of foreign scholars who join the Center's staff on an annual basis. It also participates in a fellowship program which supports research in Greece by American graduate students as well as studies for an advanced degree in economics of Greek students in American Universities.

Fellowships are also provided to young men who have graduated from a Greek University. They join the Center as junior research fellows for a three-year period during which they assist the senior fellows in their research and participate in seminars given by them.

The Center's main task, naturally, is the carrying on of research on key aspects of the Greek economy and on the fundamental policy problems facing the country in its effort to develop rapidly in the framework of the European Common Market. This research is carried on by teams under the direction of senior fellows.

The results are being published in a Research Monograph Series.

The lectures and seminars included in the Center's program are not for the benefit only of those working for the Center. Economists, scholars, and students of economics are also invited to attend and participate in this cultural exchange which is being carried out in co-operation with institutions of higher learning here and abroad. A Lecture Series and a Training Seminar Series round off the publications program of the Center.

Another need which the Center has set out to meet is the establishment of a library and a bibliographical service in the economic sciences. Besides its usefulness for the education of the trainees of the Center, this service will be of particular interest to Greek economists in general.

It is contemplated that the Center will exchange information and results with similar Centers in other countries and will participate in joint research efforts with Greek or foreign public and private organizations.

Finally, one should emphasize that this is one more example of Greek-American co-operation, a pooling of human talent, funds, and efforts, designed to promote the training of economists and help in meeting Greece's needs in the field of economic development.

The final aim is eminently practical: to help in creating a better life for the Greek people.

ANDREAS G. PAPANDREOU, DIRECTOR

THE TREND TOWARDS INTEGRATION

1. A General Trend

Today we witness a general movement toward integration; in various parts of the world nations are discussing the possibilities of combining their economies in larger units. Actually, such processes have been occurring for many years. The unification in the past of the United States of America, of Italy and of Germany are outstanding examples, and even they are preceded by older examples of countries combining to form nations and undergo comparable processes.

Today, however, there is a new wave of integration, and we are now moving on to supra-national units. The most intensive integration process, which I am going to discuss in more detail later, evidently is the one of the European Economic Community or Common Market. But, at the same time, Latin America displays three examples—in varying stages of preparation: Central America was the first region in that continent to start a form of cooperation in development combined with a customs union; the Latin

American Free Trade Area, now in the process of being formed, concerns a number of the large countries of the continent ; and, recently, the question of a similar form of cooperation, though on a more limited scale, has been taken up again in the Caribbean region. In the Arab region, the Arab League has formed a cooperative organization for trade matters and for matters of capital transfers which may also be considered a forerunner of integration. The importance of integration—in whatever form—has repeatedly been indicated for Middle Africa as well as South-East Asia. One step in the direction of intensive integration on a limited scale has already been taken in the latter region.

Also the communist countries have intensified their cooperation. In the early days of Comecon the economic intercourse of these countries was more incidental ; gradually it has been made part of a more deliberate division of labour, based on principles less and less different from those adhered to in the West.

Thus, the process of economic integration is under way in many parts of the world. To be sure, the difficulties encountered are enormous, and there is no guarantee of success. Often, vested interests or a narrow-minded nationalism resist integration. It

seems worthwhile, therefore, to investigate the economic and other arguments which can be formulated in favour of a process of integration.

2. The Essential Arguments in Favour of Integration

We shall deal with the economic arguments first. Both public and private economic activity involve matters which require, for their optimal handling, larger units than many national ones are. Most important among public activities of an economic character are those designed to implement economic policy. A number of institutions of a public character manipulate the so-called instruments of economic policy. Examples of such instruments are taxes, including import duties, public expenditures, market regulations and so on. For each of these instruments an optimum level of centralization can be determined at which they will best serve the general interest. An instrument may be handled at the local level, at the provincial, state, or federal level, or, finally, at a supra-national level. Taking as an example a market regulation, we find that some markets can best be regulated at the world level—this is true, for instance, for the wheat market. Others may be handled without danger at lower elevations however, depending

on technical factors such as the costs of transportation. If these are very high, as for dwellings, each local market can be regulated without much influence on other local markets.

Some of the most important instruments of economic policy nowadays should be handled at a supra-national rather than national level. Among these are import duties and other instruments of trade policy and public expenditures. In the Great Depression we saw how much damage was done by the national policies then pursued, sometimes indicated as beggar-my-neighbour policies. Import duties were used too much, a parallel policy of «reflation» was followed too little. If there had been, at that time, a common policy, it would have been one of reflation without increasing trade impediments. In a more general way, we may say that instruments should be handled in a more centralized way than they are today whenever there are important «external effects», that is, effects on economies, other than the policy-maker's. Moreover, such centralization or integration should involve a less intensive use of the instrument considered if the external effects are opposite to the internal, and a more intensive use if the external effects are parallel to the internal ones. In the former case

we may speak of negative integration, in the latter of positive integration. Apart from the short-term considerations just mentioned, we may also argue on the basis of longer-term effects that trade impediments should be integrated negatively—that is, lessened or even eliminated—whereas financial policies should be positively integrated. This is particularly true for an international investment policy, as I hope to set out later.

In the field of private economic activity it is investment decisions in the heavy industries which may not be optimal if they are made at the national levels. These investments, in order to be optimal, often must be larger than what the national market can motivate, and the dangers involved are those of either too small units or duplication. Some form of mutual consultation is the minimum of integration needed; but far better is a co-ordinated policy, based on a common plan, if only an indicative one.

Economic integration should as a rule be undertaken by a group of neighbouring countries. Trade relations are more intensive between countries that are close together than between distant countries (as a rule, the volume of trade between any two countries is inversely proportional to the distance separating

them. It is logical, therefore, that integration should be undertaken separately for each continent. The need for and the advantages of such integration are particularly strong for those very small countries which have emerged from the process of liberation from colonialism. This is true above all for the Caribbean area, where there are many countries with only a few hundred thousand inhabitants. It is also true for Africa and, to some extent, for South-East Asia. Many of these countries are in need of economic development but suffer from insufficient capital resources. They need a number of labour-intensive industries. These will be found more often among import-replacing industries than among those processing their raw materials, but for import replacement to make sense the market should be of a certain minimum size.

Let us now take up some arguments of a political nature. There can be no doubt that the idea of European federalism was born of the fear of Communist expansion as illustrated by the coup in Czechoslovakia. The middle-size and small countries of Western Europe felt uneasy between the two giant powers of the Soviet Union and the United States.

Another argument, of a more positive character,

may be added. It has become clearer and clearer that economic and other policies must be conceived from a world point of view. This requires an efficient organization of the world's political forces. It is not efficient to have below the highest level of authority—in principle the United Nations—more than one hundred national governing units. There is a limit to the number of «subordinates» one can efficiently deal with; often it is felt to be not more than five or six. There is a need, therefore, for an intermediate body at something like the continental level. The United Nations have already established the so-called regional commissions, but these possess no great power—indeed, just as little as the United Nations themselves. For the time being therefore, it may be useful to have more powerful units at this intermediate level. The European Economic Community may be one of these.

3. The European Economic Community : Some Facts

Let us therefore consider this organization somewhat more closely. I am first going to remind you of some well-known facts. EEC started its activities on January 1, 1958. The so-called «second stage», envisaged in the Rome Treaty, started in January 1962, almost on time. By July 1, 1962, import duties

among member countries had already been halved ; they must be eliminated by 1967. A common policy for agriculture has been established as far as its instruments are concerned. It now has to be filled up with figures. As to transportation, the principle of no discrimination against international transports has been accepted. The Commission will publish margins for the rates to be applied ; an upper and a lower limit. The quotas now applied vis-à-vis transportation services to be rendered by foreign firms will be «multilateralized» among the member countries of the Common Market.

The anti-cartel policy has been established ; an interpretation of the rule that cartels furthering the wellbeing of the Community will be exempted from liquidation can be expected soon. As to energy policy, a common one for the three communities under which it is now organized will be elaborated.

I am happy to remind you of the fact that Greece joined the Common Market, as an associate member, on November 1, 1962. A new agreement has been concluded with the associated ex-colonial areas, mostly in Africa (but also including Surinam and the Antilles). Financial assistance to these countries will continue at a level of some \$ 150 million per annum for the next five years.

The newest important event around the Common Market is less enjoyable. After much negotiating with the United Kingdom, the decision of President De Gaulle to stop negotiations was a great disappointment and a cause of irritation among most proponents of European integration. We hope that the way back will soon be found. Certainly, the entry of Great Britain into EEC was not a simple process. A few points of agreement had already been reached, such as the association of a large number of small Commonwealth countries, the convening of a world conference on the regulation of the markets of some important moderate-zone agricultural products, the organization of talks with India and Pakistan on a trade treaty, and the abolition of import duties on tea. While Britain expressed its willingness to let its agricultural policy approach the one of the Common Market, much remained to be discussed on the speed and modalities of this adaptation. It is the general feeling among all nationalities in EEC, except the official French, that as little as possible must be undertaken which would block future resumption of negotiations.

4. Some Unjustified Criticisms Against EEC

Especially in Scandinavia some prominent economists, including Professors Ragnar Frisch and Gunnar Myrdal, have criticized the Common Market for reasons which I cannot accept as valid.

One point of view they defend is that EEC reinforces the position of employers and weakens that of employees. Professor Frisch has even written that EEC will re-establish the «unenlightened power of money». This I feel is a mistaken presentation of the facts and an unduly pessimistic view of the future. As a first approximation, I see the integration operation as a neutral one with regard to social equilibrium. Looking at it in some more detail, I discern a few different forces at work of which the outcome is uncertain. Increasing competition in most industries is working in favour of consumers and hence of employees—who make up the bulk of the consumers. Also in favour of employees will be the so-called harmonization of labour conditions—the introduction of the forty-hour week and of equal pay to women and men. A more doubtful element may be the practice of the anti-cartel regulations. Everybody knows how difficult it is for government officials to cope with the many possibilities for business to

circumvent anti-cartel laws. Perhaps one may conclude that it depends on who will be quicker—the employers or the employees—to organize themselves at the European level. I see it as an encouraging fact that the Socialist parties were the first to come up with a unified program.

A second point of criticism, to be taken more seriously, is the forecast that upon the establishment of the one-market area there will be a tendency for economic activity to concentrate in the most highly developed region—namely, the Ruhr basin. No doubt, similar phenomena were observed after the unification both of the United States and of Italy. In both countries the South was «drained» of capital and qualified manpower as a consequence of the advantages of large-scale production and external effects. Such a thing might well happen with the Common Market also—thus it is argued. The answer is that the Rome Treaty, to begin with, foresaw some of these problems and, for that reason, established the European Investment Bank, in order to assist industries and regions which might suffer from the competition created. More important, I think, is the general spirit in which regional development and full employment are nowadays envisaged by the governments

of the six countries. It looks very improbable indeed that any development of the type feared would remain unanswered.

A third point made by my opponents is, I think, by and large correct : they contend that the economic advantages of joining and the disadvantages of not doing so are exaggerated by many of the proponents of integration. Although we must state, I fear, that our knowledge of these points is alarmingly imprecise, I agree with them. The increase in real income to be expected from the creation of EEC, should not be estimated to be more than some 5 per cent.

5. Some Justified Criticisms

There are some other criticisms directed against EEC which I share and which, in the opinion of a strong minority in EEC, should eventually be met. One is that the Common Market is too protective. To be sure, it is no more protective than the group of the six countries (forming four customs areas) was before. The outer tariff is the unweighted average of the tariffs previously existing in the four areas. Yet, as a whole it is too high. A unit as strong as EEC must set a good example and not be protective at all. Now we protect agriculture rather heavily and quite a few industries in a moderate way but also too

much. An outstanding example in agriculture - though not a representative one - is sugar, and one in manufacturing is cotton tissues. Both cases of protection should eventually be eliminated, even though, of course, some safeguards against acute market disturbances can be accepted.

Intimately connected with the phenomenon of protection is the one of discrimination in favour of some associated countries and to the detriment of their competitors. This is a consequence of the existence of duties, of course, and will diminish together with such duties. EEC must feel itself more responsible for such continents as Asia and Latin America and the non-associated part of Africa and behave accordingly. We can help our associated countries in other ways, more particularly by technical and financial assistance. Some first steps have already been taken on the correct road: a reduction in tariffs on some tropical products has been implied in the new association agreement for the tropical countries.

6. Positive Possibilities of the Common Market

Notwithstanding some of the less attractive features of EEC just discussed, I think its creation represents an important contribution towards a better international policy. The most important feature of

the Common Market is that it constitutes a new partner in the dialogue on world politics which so far has been the exclusive privilege of the United States and the Soviet Union. EEC will not be a comparable unit in the military respect; but it is in the socio-economic field, and that is even more important. There is a need here for a unit of this size having at the same time its own «social face». It takes a less doctrinaire stand in the big controversy about the socio-economic system, in that it applies and defends a mixed economic system, with a considerable public sector and with a status for workers' organizations different from the American pattern.

It must and can use its influence to embark more intensively on a world development policy for the developing continents, under conditions of stable primary markets. Such a policy requires some key measures of an international character. Transfers of capital and of education, a less protective trade policy, and measures to counteract the heavy fluctuations in the export receipts of the developing countries are the most important ones. At the highest level that is, that of the United Nations, some central planning will be needed. I have elaborated ideas elsewhere (1)

(1) J. Tinbergen, *Shaping the World Economy*, (New York : Twentieth Century Fund, 1962).

and may refer to that elaboration without repeating it here. A united Western Europe could play an important role as an animator of such a policy; together with the United States it could be a force for good and make a constructive start. This is the main reason why I look positively at the Common Market as a point of crystallization in the process of advancement toward world economic development.

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