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Britain's Joining the EEC Promotes Growth

By Ernst Meyer, Hamburg

Four years after the failure of the first negotiations on joining the Common Market, on May 11, 1967, the British Government again made an application for the country's admission to the EEC. Parliament's unequivocal majority authorising the Government to embark upon these negotiations and the fact that there are no "ifs" attached to this application are an expression of a twofold acknowledgement: 1. Britain as part of the West European industrial centre in the long run cannot find a true compensation for a closer integration with the European focal countries either in its traditional relations with the Commonwealth or in the "emergency societies" as e.g. EFTA. 2. Today the success and with that the attraction of the EEC are greater than ever before.

This attractive power must work particularly on a country like Britain that—on the average of the post-war years—experienced but a very small growth. The unsatisfactory growth rate is a consequence of an economic policy known as "stop-and-go policy", to which the Government was forced since growth was domestically orientated. Whenever as a result of an increase in domestic demand a process of expansion had set in, contractive measures had to be taken after a certain period. For the country's imports rose more than proportionally in consequence of grown incomes. Moreover they led to balance of payments deficits which the country could not afford in the long run, in view of its currency reserves being completely insufficient in proportion to its short-term foreign liabilities. The check to demand largely obtained in each instance, through monetary measures, slowed down the development of imports. Apart from this slowing down of demand the inflow of short-term foreign assets as effected by high domestic rates of interest led after some time to an easing of the balance of payments. At the same time, however, the restrictive measures had an adverse effect on investment activities and thus on growth. The smaller growth rate, however, brought about insufficient improvement of productivity and weakened the country's export position in later periods.

The attempt to reach a transition from a domestically orientated to an export orientated growth would be a chance to break through this vicious circle. For, in case the growth impulse came from abroad this would have two positive consequences: First, high foreign demand would lead to increasing investments in the

field of exports and thus improve the country's export chances in the long run. Second, in the course of a process of expansion the hitherto unavoidable balance of payments deficits would not recur anymore, because rising imports would be balanced by higher exports. An ever recurring interruption of growth for balance of payments reasons could be avoided this way. As in the long run an uninterrupted growth means also a faster one, and a higher growth rate is accompanied by more vigorous advances in productivity, this development would finally lead to an improvement of competitiveness in the export markets, too.

Joining the EEC would offer Britain a chance of obtaining this transition to export orientated growth, i.e. of simultaneously realising the solution of the balance of payments problem and an increase of the growth rate. First, however, some problems have to be solved that such an accession to the Common Market would raise for the country at least under short-term aspects.

Even before the parties concerned have entered into the actual negotiations, it may be stated that Britain's initial position—apart from the politically motivated opposition of France—is weaker today than it was in 1961. Thus the solution of the agricultural problems appears to be considerably more difficult, since in the meantime the EEC established its agrarian market regulations. In addition the liberalisation of capital movements as initiated in the meantime within the Common Market is raising additional problems for Britain's balance of payments position, which since the negotiations on joining the EEC has deteriorated anyway. Only the difficulties regarding the Commonwealth relations decreased.

The Solution of the Commonwealth Problem

The post-war development of trade within the Commonwealth, that today is of much smaller importance to both sides than it still was ten years ago, is corroborating the fact that the solution of this complex of problems should be much easier today than at former negotiations on joining. In consequence of this development the Commonwealth countries are looking more eagerly for new supply and sales markets. This is to be observed clearly e.g. by Australia's orientation towards Japan and the United States, and Canada's ever growing integration with the United States. Other states, as for instance Nigeria, some East African

countries or also India, are applying for association with the EEC. This development might make Britain's accession to the EEC easier. However, it must not be ignored that a possibly abrupt discontinuance of traditional trade relations in the short run would involve considerable export losses for those concerned. This is valid particularly for countries with a one-sided export structure.

For Britain the loss of its Commonwealth preferences should have less serious effects. At least the country might put up with this loss all the better as by way of compensation Britain would obtain preferences in a much more vigorously expanding market. Moreover, price increases as a result of more expensive raw material and food imports should be balanced by cheaper imports of finished products from the Common Market.

The disadvantages arising for the Commonwealth countries from Britain's joining the EEC do not primarily consist in a loss of all preferences their products are hitherto enjoying in the British market. What matters more is the fact that in future on the British market they will be discriminated vis-à-vis the other EEC countries by means of the common external tariff. This external tariff does not affect all Commonwealth countries to the same extent. It applies in particular to the producers in the so-called low-price countries (Hongkong, India), whose future exports will be limited additionally by import quotas as fixed by the EEC. Temperate zone countries (Australia, New Zealand) with agrarian exports will also sustain losses. If no special arrangements are agreed on, future agricultural exports from these countries will hardly be possible anymore due to the EEC import levies. Finally in the Common Market some Commonwealth countries in Africa and the Caribbean area are discriminated vis-à-vis the former French colonies associated with the EEC. In order to solve this problem the agreement already obtained in former negotiations could be used as a starting-point for an association of these countries, too. Proposals for a solution of the other groups of problems have also been made in former negotiations. The separation effect of Britain's joining the EEC would be already considerably alleviated for most of the Commonwealth countries, if transitional periods of sufficient length would be fixed, at the end of which Britain would then have to apply the new external tariff of the EEC also to its imports from Commonwealth members. During these intervening periods of between five and seven years (according to countries and products) these countries would have a chance to diversify their export supplies or to look for new markets. Strictly speaking only the handling of the low-price countries' exports of finished products, that are limited by EEC import quotas, would remain problematic. The same applies to the agricultural exports of New Zealand which make up 75 % of the country's total export, and of which Britain alone is buying 50 %. It is quite obvious that in this particular case a long-term sales guarantee would have to be agreed on. A possible solution of the

difficulties as regards finished goods exports of low-price countries would be obtained by fixing sufficient large tariff quotas.

The Burden Resulting from the Acceptance of the EEC Agrarian Policy

If the abandoning of the Commonwealth system of preferences means an incomparably smaller loss for Britain than it does for its former partners, on the other hand, the additional burden accruing to the country by the acceptance of the EEC farming policy is considerably heavier. Apart from the already mentioned difficulties for some countries' agricultural exports, the adoption of the Common Agricultural Policy (CAP), would have in the main three consequences for Britain:

- ☐ a change of the present system of agrarian subsidies and therefore rising food prices,
- ☐ an alteration of the agricultural producers' income situation,
- ☐ an additional burden on the balance of payments as a consequence of more expensive food imports and of direct payments to the European Agricultural Guarantee and Guidance Fund (FEOGA).

All these difficulties had become visible already in former negotiations on Britain's membership. At that time, however, their extent could not yet be perceived, since then the EEC had not yet passed its agrarian market regulations and thus the Common Market prices of individual products had not been fixed yet. Meanwhile, however, it is possible to state to what extent consumers and producers as well as the balance of payments will be involved.

According to estimates made by the British Government a transitional period of three to five years would suffice in order to avoid a sudden increase in the cost of living and a general wage raise, if the present agricultural prices in the EEC and the world market are taken as a basis. But it remains uncertain how much the British future budget will be burdened by payments to FEOGA, as independent of the levy payments further direct budgetary contributions to the Fund may be demanded of any member in order to carry through interventions into the market and measures for structural improvements. Two factors should essentially determine the extent of direct payments from the British budget to the Agricultural Fund¹: The Fund's volume of expenditure and the degree of self-sufficiency that the EEC will achieve in the agricultural sphere.

It is obvious that in the negotiations on joining the Common Market Britain will urge strongly for keeping these payments as low as possible, all the more as owing to its being a net importer of farm products the country would receive but very low drawbacks out of the Fund. However, the chances that the Six will comply with this wish should be very small indeed.

¹ T. K. Warley, *Agriculture: The Cost of Joining the Common Market*. European Series No. 3, London 1967, p. 44 seqq.

A chance of improvement will only exist when the EEC agricultural prices will be revised, and Britain—possibly as a member—may then advocate the lowest prices possible.

According to the different estimates, the British agricultural producers will, on balance, not sustain losses worth mentioning by CAP. In future they will not be subsidised by the taxpayer anymore, who so far paid them the difference between world market prices and guaranteed internal prices (1963: £ 250 million) but directly by the consumer. Nevertheless the new agrarian price system will differently affect production and costs and thus the development of incomes in the individual spheres of farming. The relatively high EEC price of grain will probably encourage production in this field. At the same time increased costs of feeding stuffs will impair those processing branches of farming which have a particularly high proportion of fodder costs, as they will hardly succeed in passing on these higher costs to the consumer. With the exception of beef production the whole processing industry would therefore experience a set-back. Thus for British farming a new agricultural policy will involve a number of adjustment problems and structural changes. The fact that the EEC agrarian price system envisages fixed prices for certain products only, while British farming policy provides guaranteed prices for a wider range of agricultural products, involves for individual groups of British farmers an additional uncertainty about the development of their incomes. As a consequence of this differing set-up of both systems, considerable income fluctuations might possibly result for some agricultural producers in Britain. An agreement on a transitional period seems therefore to be necessary in order to avoid hardships caused by this process of adjustment.

Liberalisation of Capital Movements

Another problem is raised by the prospective development of the balance of payments as a result of the liberalisation of capital movements. As is well known, Art. 67 of the EEC Treaty provides for the progressive dismantling of restrictions on movements of capital among member countries. To Britain this would mean that it would have to revoke, at least vis-à-vis the Six, its rigid exchange controls limiting capital movements with countries outside the sterling area. What would be the presumptive consequences of a liberalisation of capital transactions with EEC? If we adhere to the usual classification of foreign investments by portfolio investments and direct investments, the following may be stated: As long as Britain's interest rates are above those in the other EEC countries and as long as the country succeeds in effectively opposing devaluation rumours, it should be possible to avoid a net outflow of capital to the Six, stemming from portfolio investments. However, the UK faces the difficulty that the EEC countries did not only liberalise capital movements among themselves but also vis-à-vis third countries. This fact might bring about the danger that

after the removal of foreign exchange controls vis-à-vis the Common Market, British capital might flow to the United States via the Continent.

It is quite certain that as regards direct investments a net capital outflow will take place—although probably on short-term only. For, on the one hand, British industry has a certain pent-up demand for foreign investments in the EEC, and, on the other, at present the average growth rate is still higher in the Common Market than in Britain, so that via capital export an increase of the marginal efficiency of capital would be obtainable for British industry. With regard to these tendencies towards an outflow of capital the British Government, however, presumes that as a consequence of joining the EEC, foreign investments in Britain would increase again. Particularly it is hoped that Britain will again attract a bigger share of American investment abroad². In this connection the British Government's liberal attitude vis-à-vis foreign investments might play a certain part. But it should not be ignored that the continental locations in most cases will be more favourable for the supply of the total market. Finally an EEC stipulation in preparation, obliging each member nation to open its partner countries its domestic capital market would possibly involve a capital outflow and affect the British balance of payments adversely.

One thing, however, appears to be certain: The liberalisation of capital movements will render London even more attractive as a financial centre. The demand for capital will increase considerably. In this situation it is important that the supply of capital is growing, too. Domestic savings do not suffice for this. Foreign capital, however, will flow to London only if the confidence in the British currency can be maintained. But in the long run this confidence will only be won if the trade balance is favourable. Since this improvement will be favoured only in the long run by joining the Common Market, it seems to be necessary to proceed but gradually with the liberalisation of capital transactions. Another aid for Britain would be the official pledge of the other EEC members to secure the value of the pound sterling possibly with stand-by credits so that a possible pressure on the rate of the pound as a result of capital exports does not lead to apprehensions of a devaluation and a sudden withdrawal of sterling balances.

The Influence on the Balance of Payments and on Growth

It has been pointed out so far that satisfactory solutions may be found for the three groups of problems that have to be solved in the negotiations on Britain's joining the EEC. But there still remains the influence of the entry into the Common Market on the country's balance of payments and its economic growth to be examined.

² The Economist No. 5454, of May 6-12, 1967, p. 502.

Britain's chronically weak balance of payments position forces the country as regards such a far-reaching economic policy decision—as in the case of joining the EEC—to take into consideration other possible influences on its external situation over and above the effects on the development of capital movements. However, any quantifying of the positive and negative factors is, apart from the agricultural sphere, extremely uncertain even under short-term aspects.

Therefore estimates of the probable burdens on the balance of payments after the end of the transitional period are fluctuating very much. They vary between £ 250 million and £ 600 to 800 million p.a. All estimates are agreeing only on the assumption that the positive effects of joining the EEC will only appear in the long run, and thus on short term do not play a role. Depending on the individual estimates, a more or less important share of the about £ 700 million additional expenditure on food will affect the balance of payments. In any case food imports, no matter whether from the EEC or from third countries, will become more expensive. Estimates of the extra burden on the balance of payments caused by dearer food imports alone fluctuate between £ 170 million and £ 250 million p.a.³ Levy payments alone to FEOGA will amount to about £ 170 million p. a. according to the present estimates.⁴

More difficult to quantify is the influence of increased cost of living via wage raises on the general price level and thus on export developments. Uncertain is also how the loss of Commonwealth and EFTA preferences as well as the enhanced pressure of the other EEC countries' competition would affect exports and imports. Surely a short-term pressure on the balance of payments may be expected from all these factors. The extension of this pressure will depend on to what extent British industry will succeed in raising its productivity so rapidly and lastingly under keener competition that it can utilise the chances of the bigger market and make a short-term contribution to the easing of the balance of payments situation via increasing exports. The main prerequisite to this is in any case that the Government relaxes as soon as possible its policy of restriction in order to enable industry to adjust itself to the new conditions.

However, the short-term balance of payments burdens have to be compared with the better export chances that in the long run will result from increased growth rates induced by joining the EEC. This influence on growth might become effective in several ways. First the country's export activities would profit from the high growth of incomes which the EEC countries could

realise hitherto. In a country with a relatively high degree of foreign trade integration and a comparatively unfavourable regional export structure the extensive and steady development of demand in a large market should have a favourable effect on the entrepreneurs' expectations and thus on investment activities and growth. In addition integration enables an improvement of productivity and growth through a better utilisation of economies of large scale.

What quantitative importance these economies of large scale may have in certain lines of business is shown by a comparison of productivity between the chemical industries in Britain and the United States. This comparison reveals that two thirds of the advantage the United States has in this industry can be traced back to economies of large scale.⁵

The opening up of the national market will finally have the result that the foreign competitors will force the country's entrepreneurs to strive more vigorously for cost reductions and to speed up the improvement or adoption of new production methods. Apart from this, increasing pressure of competition accelerates structural changes in industry. Bigger enterprise units will be established. Owing to the size of their profits and the funds available to them they will be in a position to incur heavy expenses for research and development.⁶ This again enhances the possibility of a better utilisation of technical progress and thus enables a better and/or cheaper supply of goods. At the same time sales in a bigger market offer a chance to obtain from the market a remuneration for the steadily rising expenditure on research and development.

Finally it has to be taken into consideration that in some fields (electronics, reactor and aircraft construction) research and development expenditure has grown to such dimensions that not only on a national basis Government and private economy have to concentrate their funds, but that cooperation in the European market will be required if the technological gap between Europe and the United States is not to deepen even.

A final attempt to judge Britain's joining the EEC with regard to the targets of balance of payments equilibrium and growth shows that in the short run the probable result will be a burden on the balance of payments. This burden, however, could be made easier by an agreement on transitional periods of sufficient duration. In the long run, however, joining the Common Market should lead to an increasing growth rate and thus influence favourably also the development of the balance of payments via an improvement of productivity.

³ Confederation of British Industry, *op. cit.* p. 26 seq., T. K. Warley, *op. cit.* p. 40 seqq., The Times No. 56929, May 1, 1967.

⁴ This figure has been ascertained taking into consideration possible changes in demand and adjustments of domestic production in consequence of higher farming prices.

⁵ See: The Economist No. 6450, April 8, 1967, p. 156.

⁶ D. Swann and D. L. McLachlan, *Concentration or Competition: A European Dilemma?* London 1967, p. 7 seqq.