

Predöhl, Andreas

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Politics and Economic Rationality

by Professor Andreas Predöhl, Münster *

When we approach a re-alignment of our foreign trade and currency policies, it becomes progressively more advisable that we examine the fundamental questions carefully which form the background of the whole problem. Unfortunately, such questions are too much veiled from the eyes of the public by political debate, which is carried on in the foreground. That the European Economic Community will have to be modified and enlarged had become a truism even before General de Gaulle's disappearance. The task is tied up so closely and so inevitably with the natural laws of further development that facing it cannot be forever avoided. It is no valid objection that all events are ultimately dependent on political decisions. If policies violate too often, and too deeply, the requirements of economic rationality, they become self-defeating, and the economy enforces their return to common sense. It is even possible to make a fairly precise assessment of the degree up to which the economy is able to tolerate deviations from economic rationality, which means that we are able to distinguish between those things that are possible, we may go further and separate probabilities from improbabilities. In other words, our forecasts may be based on reasonable certainties.

Whither the European Common Market?

That the economic integration of Europe is inevitable has been shown by the big world slump of 1931. It was then that cyclical automatism, which till then had ruled economic developments, broke down for good. Depression could be overcome by anticyclical state intervention only. Cyclical automatism was replaced by national economic autonomies. However, price levels which are manipulated autonomously require, as their counterparts, either floating rates of exchange or currency controls. If we want to preserve the present system of currency relationships, this will only be possible on condition that price levels are harmonised through individual governments agreeing on common anticyclical policies.

On the other hand, worldwide agreement of this kind is a utopian dream. And such worldwide harmonisation is not even necessary, for if we trace the effects of national frontiers having become economically relevant after the rise of independent national anticyclical policies on to the patterns of world markets, we find that America's industrial sphere of influence has hardly been touched by them. Of course, America, too, trades internationally, but in spite of America's immense importance for the world's markets, the volume of its foreign trade is virtually negligible compared with the enormous trade turnover within the giant United States. Similar observations are true of the Soviet Union. In Europe, conversely, national frontiers cut right across the powerful and highly sensitive flow of exchanges within the industrial heart area. Consequently, our task is to restore to the industrial areas of Europe the dominant position which they occupied in the age of worldwide liberal integration, a position which the two other industrial centres had never lost. This is the underlying meaning of European integration.

But the European Economic Community cannot fully grapple with this task, as long as it unites only part of the European industrial power field. Its effects which promote trade, in Viner's sense, are too weak, compared with the obstacles in the path of trade set up in an area that is still too small. Above all, the EEC ought to absorb the industrial agglomerations of the British. At the same time, joining the EEC is of vital necessity for the UK. Britain has always needed worldwide exchanges, and it may be that it cannot survive economically without free trade. But there is only one way back to free trade: European integration. The troubles of the British balance of payments could almost be wiped out by the UK becoming an integral part of the EEC. The economic forces pressing for such a solution on both sides have already become too strong for political antagonisms being able to hold up the merger for ever.

Merging EFTA with EEC

These conditions make it inevitable, as well, that the EEC will one day absorb EFTA. Frequently enough, we are told that it might be as easy to

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attach the EEC to EFTA, going the reverse way. But what would such an attachment mean? Proposals to do without integration of national economic policies, and to be satisfied with setting up a bigger Free Trade Area, are simply useless. EFTA is an example of a free trade zone, and free trade alone is unable to lead to integration in an age of independent national anticyclical policies. Admittedly, integration of the national anticyclical policies in the present EEC is unsatisfactory and has not even reached what free trade might offer, but this does not prove the principle to be wrong. In this sense, the French are eminently justified in demanding of the British a clear and unequivocal adoption of EEC principles, because anything else would mean that we give up striving for integration.

Moreover, EFTA is much too much split up into splinter areas geographically. It consists of countries which lie on the outskirts of the Common Market, most of them much more closely dependent on their EEC neighbours than on the British industrial heartland, and the attempt is now being made to direct their trade flow to this British centre, which is too small for the area, by purely free trade arrangements. As a counterstroke against EEC, this may have had its passing justification, but in the long run, EFTA is unable to solve its own problems.

Association of the peripheral overseas countries with the centre, by free trade measures, will not operate with inevitability. If such association is restricted to part of the overseas periphery, e.g. to the former Communauté Française, this will distort the worldwide division of labour. If association will be extended to additional countries, e.g. the members of the British Commonwealth, this will be an approximation to worldwide free trade links—and this is the ultimate aim of true European integration. That trend is being strengthened by the rising clamour of other

countries, including those of South America, for European trade preferences. All these are steps towards a new system of free world trade, which will progress by steps via regionalism to a worldwide system. The Kennedy Round would have ended much more successfully, had it been possible to place a fully developed EEC in the seat of the negotiating partner with the US.

It becomes clearer virtually every day that currency problems, likewise, can be overcome only by stages, creating regional unity first. It is conspicuous that an all-embracing system of currencies, which present negotiators are still trying to re-establish, can never go beyond pragmatic expedients. But this bogs the world down in compromises which will not do away for ever with perennially recurrent currency troubles. As long as the fundamental difficulty—the harmonisation of national anticyclical policies—has not been overcome, rising disparities between national price levels will make occasional revaluations or devaluations inevitable.

The Rise of COMECON

COMECON, the Council for Mutual Economic Aid, consists of the economic association of the Soviet Union with the other member states of the Communist Bloc in Europe. As its member states adhere to a planned economy, it would have become operable, similar to the EEC, only on condition that it was headed by a central planning authority. In the beginning, this condition was practically met with by its initial raison d'être having been to serve the overriding planning aims of Soviet economic policy. But this, of course, did not bring about an international division of labour, which is a benefit for all participating nations, it rather made the Council an instrument of economic exploitation. Later, the trend towards economic division of labour prevailed, and this has done away with the central



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authority. The effect has been that COMECON has not been able to go far beyond concluding a number of bilateral agreements between its members, for it is very difficult, probably even impossible, to plan for multilateral exchanges. Planned exchanges, on the other hand, permit also of COMECON members making bilateral agreements with Western countries. The nations dwelling on the Eastern outskirts of Europe have always been gravitating towards the central European industrial heartlands, especially towards Germany. At the end of the Second World War, their former political role of having been part of the Eastern marches of the European agglomeration of forces was forcibly transformed into their present one of a western glacis for the Soviet orbit. Economically, especially because of the high costs of overland transport, this is against all the rules of rationality. It was therefore to be expected that their economies should develop contrary trends—partly towards national industrialisation to develop more or less of an autarky, and partly towards rising exchange volumes through trade with Central European countries.

Soviet east-west trade is also growing, but this is a different kind of exchange between two big

industrial agglomerations. We are ignorant of the extent up to which the economic benefits of this form of exchange are being utilised, because the foreign trade of such giant empires as that of the Soviet Union is much less sensitive to purely economic pressures than that of small and marginal nations. A parallel case is that of the United States' protectionism, and economically, the Soviet anomalies are more strongly developed since, for the Soviets, political decisions mostly prevail over economic self-interest.

What is generally termed „east-west trade“ is composed of many different kinds of trade, with differing economic contents. At any rate, east-west trade tends to grow, even in cases where the policies of certain eastern states seem to militate against it. Conversely, it is abstruse and makes scant sense for western nations to fight against the evolution of this trade with political weapons. The view that it may be possible to exert political pressures by imposing embargoes on so-called strategic goods, for example, as in the notorious case of stopping German steel pipe exports, is completely short-sighted. Such an attitude is based on complete misunderstanding of the degree of interdependence between politics and the economy.

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