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Economic Integration: Theoretical Assumptions and Consequences of European Integration, by Rolf F. Sannwald, and Jaques Stohler

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ECONOMIC INTEGRATION: THEORETICAL ASSUMPTIONS AND CONSEQUENCES OF EUROPEAN INTEGRATION. By Rolf F. Sannwald and Jaques Stohler. Princeton: Princeton University Press. 1959. Pp. xvi, 260. $5.00.

There is an interesting divergence between the actual development of, and the theories of economists on, economic integration. In Western Europe, the new institutions of economic integration sprang from the power oriented goals of national economies. In economic theory, however, these efforts at integration are analysed in terms of pure economies and ideal goals. These aims are maximum economic welfare or completely equal treatment of all participants in exchange of goods. The result of this divergence is that economists do not come to grips with the economic consequences of the power oriented forms of economic integration.

The European Coal and Steel Community resulted from a peculiar power constellation that grew out of World War II. The victorious Allies had imposed unilaterally the International Ruhr Authority through the use of which they controlled the German heavy industries. While France consistently tried to keep this control out of German hands, the United States exerted pressure for a German rearmament in response to the Korean War. Shift in American policy provided an opening for the German government to terminate the unilateral control. Adenauer was the first among the powerful who proposed a supra-national "organism which would embrace the basic industries of the other European countries as well."[1] The ball was picked up by Schuman who succeeded in obtaining a High Authority that was to permit an increase in German steel production without giving West Germany the opportunity to increase thereby its political and military power.

The Common Market has been equally a product of power politics. Its ultimate origin lay in the Russian threat to Western Europe. A compromise between France and West Germany constituted the immediate origin. The Adenauer government was willing to accept Euratom with its monopoly of knowledge, skills and products. Under joint Allied pressure, Adenauer accepted also the German renunciation of manufacturing atomic weapons. In return for these concessions Germany succeeded in getting the new organization of the Common Market accepted by France.

1. DOCUMENTS ON GERMANY UNDER OCCUPATION 1945-54 at 419 (1955) ed. by B. Ruhm von Oppen.

Enjoying modern plants and lower unit costs, German steel concerns not only desired ready access to the product markets of the other member countries but also sought a reliable supply of North African ore and other investment opportunities. The French demand that the colonial territories be associated with the Common Market and that each member contribute a certain sum to a development fund, became thus acceptable to West Germany.[2]

All three supra-national institutions dealing with steel and coal, atomic energy, and with the Common Market, thus generated from the power politics of national states. In addition to their economic significance, the respective treaties were signed in the expectation that France would gain politically and West Germany economically from the operation of these international institutions. The same power politics has also been responsible for the fact that Western Europe has become divided into sixes and sevens. The immediate goals of the French-German alliance are thus endangering the ultimate goal of increased strength for Western Europe relative to the Soviet Union.

Rather than analyzing the various national economies and ascertaining the allocational effects of their power goals, many economists examine the economic consequences of the supra-national institutions in terms of an ideal economy. One line of thought concentrates upon economic integration which is defined ideally as "the realization of the old Western ideal of equality of opportunity."[3] It is implied that the national economies have or will become welfare states. The international treaties are thus evaluated as either adequate or inadequate instruments for extending equal opportunities and economic equality to all the member states. Another line of thought applies the current theory of international trade to the international institutions. Their economic actions are examined in terms of maximum economic welfare and equal treatment of all traders. It is usually asserted that the tariff reductions and quota eliminations of an economic union involve necessarily discrimination for third parties.[4] The usual inference is that regional integration of national industries or economies are quasi-monopoly structures that lead to monopoly-like profits for the member states and thus to a reduction of the gains from trade for other countries.

The authors of the book under review seek a reconciliation of these two strands of economic analysis. This involves a twofold task. Eco-

2. *Cf.* E. STRAUS, COMMON SENSE ABOUT THE COMMON MARKET 62-71, 83-91 (1958).

3. GUNNAR MYRDAL, AN INTERNATIONAL ECONOMY 11 (London 1956).

4. For the most elaborate treatment of this discrimination argument see J.E. MEADE, THE THEORY OF CUSTOMS UNIONS (Amsterdam 1955).

nomic integration is seen not only negatively as a removal of trade restrictions but also as a method of unifying national currency and tax systems, and of providing an opportunity for intra-union mobility of labor and capital. The analysis of this enlarged set of problems proceeds in terms of free trade and welfare theories. Yet the hope is that by revealing the underlying assumptions and by replacing them by observable facts, via a sequence of increasingly realistic models, it will be possible to arrive at a unified theory of economic integration. The expectation is that a successful handling of these tasks will show that regional integration will necessarily bring gains that exceed the losses involved for third parties. Did the authors succeed in realizing their goal?

The analysis begins with the theory of universal free trade, which is attained either by optimization of trade or by maximization of production. Yet such a situation in which no further benefits can be derived from either an increase in trade or an increase in production hinges upon the two assumptions that income is already equally distributed and that the supply of factors cannot be further increased. When these two conditions are not present, a country can benefit from imposing tariffs and increasing its volume of production. Infant industries, rigidity of prices and wages as well as involuntary unemployment or internal economies, furnish additional reasons for trade restrictions. These restrictions impose limitations upon free trade and some of them bring net gains for the countries involved, while most financial and direct controls create a benefit for one country only that gains at the expense of other countries. Free trade is thus politically difficult to attain but economically the best means for increasing the standard of living for all countries concerned.

What are the advantages of a regionally free trade? Using the distinction that a customs union creates as well as diverts trade, the authors do not accept the thesis that the losses of a diversion are necessarily greater than the gains from a creation of trade. An economic union will lead to an expansion of trade because of the reduced trade barriers. Economic welfare will be increased, via the union, if the original tariffs were very high, if the integrated economies become complementary to each other, if the area of the union is large relative to the outside world, if the removed barriers took the form of quantitative restrictions, if the advantages of mass production can be realized because of the union, if the discriminatory measures of the union can be minimized by appropriate counteractions.

The comparison between universal and regional free trade leads the authors to the conclusion that economically the former is the best, the latter the second best, solution of the international trade problem. Politically, however, the regional solution is attainable while world-wide free trade is not. The method of comparing hypothetical models with each other has thus produced the result of defining more concretely the desired goal: free trade within the region to be integrated. At this point, however, the method of successive approximation is abandoned. No attempt is made to define the typical features of a modern national economy and compare them with the ideal of a regionally free trade area. Only an analysis of the typical national economy would provide the opportunity to discover whether the various forms of European integration really aimed at regionally free trade, and whether they did adopt the correct means for achieving such a goal.

Suffering from a decisive gap in their theory, the authors are then ill equipped to examine the methods that should be adopted to achieve integration. If the goal is to attain regionally free trade, an economic union would then have to adopt the whole program of neo-Liberalism. Economic welfare by free trade would require abolition of all trade restrictions, a common currency based upon a modified gold standard, a free foreign exchange market linked with readily adjustable rates of exchange, a unified banking system, flexible prices and costs in all parts of the union, full regional mobility of workers and capital, a coordinated system of taxation, an effective antitrust policy, and a full employment policy for the whole region. Application of these methods would thus call only for an investigation of the timing and sequence according to which the various policies should be introduced.

Rather than accepting this program of neo-Liberalism, the authors prefer the institutional method for attaining economic union. This method is not limited to removal of trade restrictions but regards the policies of national economies since World War I as irreversible. Viewing these national policies as falling all under the heading of economic welfare, the rule is laid down that the benefits of such policies must be extended to all members of the union. Internationalization of such national benefits calls for rearranging old and for creating new economic institutions. Without further investigation, the authors take it for granted that the objective of institutional innovation is "to equalize welfare in the West European countries." This goal induces them to propose the establishment of an European investment bank and a central organ of economic policy for the union. The creation of unified but stable regional markets is to be achieved not only by trade liberalization but also by a market regulating body and by the exclusion of monopolistic practices. This new pattern of institutions must be given a permanent character and must thus be safeguarded against sudden changes by member states.

In analyzing the specific form and functions of the new institutions, the authors largely drop their institutional method. In their long chapter on monetary stability, for instance, they "search for the optimum currency policy" in the fashion of neo-Liberalism. The question is thus no longer what institutional changes are feasible and practicable in a reasonable period of transition. The institutions desired must now pass the test of optimum efficiency of an ideal economy. In the monetary field the authors thus suggest the need for a common currency, for a regional banking system based upon 100 percent reserves, for a supranational authority of financial policy, and for a single import authority. If such "optimum" institutions are politically not acceptable, the authors propose as their second policy a system of variable exchange rates for maintaining monetary equilibrium of the union, internally and externally.

Yet even this alternative policy requires for its effectiveness a set of supranational institutions that assure harmonization of wage policies among the member states and protect the national currencies against destabilizing speculation. Such protection calls for a European Monetary Fund which is welcomed as a forerunner of a common currency. The system of flexible rates and free exchange markets is thus not expected to operate by itself but these markets are in need of supranational intervention. Both proposed policies of monetary stabilization thus call for new regional institutions that are hardly acceptable to the states dominating the common market.

Having first argued against and then accepted the position of neo-Liberalism, the authors regard the present integration efforts with great misgivings. They conclude their study with the usual remarks of despair "that the development of the Economic Union will follow a course similar to that of the national integration of feudalist countries in the nineteenth century." Yet this disappointment is a product of a self-produced illusion that springs from theorizing in terms of an ideal economy. Perfect competition should not be mistaken for economic democracy. Economic unions must then either have all the optimum institutions of a perfect union, or any less perfect form of economic integration is not worth having. These illusions and the subsequent despair can be overcome only if economists leave the wonderland of an unattainable perfect economy, develop a theory of the capitalist national economy and propose those institutional economic changes that are compatible with the simultaneously existing profit and power goals. Such a theory only will be useful for politicians, administrators and lawyers who see it as their task to make European capitalism more viable through a common market.

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