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Possible effects of the Free Trade Area on the European trade of non-member countries

Report¹

Committee on Economic Affairs and Development

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A. Draft Order

1. The Assembly,
2. Taking note of the preliminary report on the possible effects of the Free Trade Area on the European trade of non-member countries, submitted by the Economic Committee;
3. Convinced that European economic integration is perfectly compatible with, and should be accompanied by, measures for the progressive freeing of trade and payments on a worldwide scale, in the interests of Western Europe as well as of overseas countries;
4. Convinced that a high rate of economic activity in Western Europe within a system of free world trade is of benefit to the less developed countries, also but realising that special measures of assistance to promote their exports and improve the living standards of their populations will be needed and that this problem should be closely and continuously studied from the outset,
5. Instructs the Economic Committee to continue its work and to report on its conclusions to a subsequent Session of the Assembly.

B. Explanatory Memorandum

1. Introduction

1. In 1956 Western Europe's exports represented 41% of the world total, a little less than half of this share, 19 %, going to countries outside the area. The bulk of these latter exports (69 %) were destined for primary producing countries.
2. On the import side Western Europe in the same year accounted for 45% of the world total, a little more than half of this share, 23%, being imports from the rest of the world. The bulk of these latter imports originated in the primary producing countries (57%) and in North America (30 %).
3. These summary facts illustrate not only the key position of Western Europe in world trade but also the particular importance of its trade with primary producing countries.² At the same time, the West European trade of these latter countries comprises almost three-fifths both of their imports from and their exports to countries outside their own category.
4. Primary producing countries have seen their share in world exports drop from 31 to 30% over the past 20 years, while simultaneously their share in world imports has risen from 25 to 30%. This development has been particularly pronounced in recent years, especially as regards the relative decline of exports from primary producing countries. The result has been that a trade surplus of 2,800 million dollars for these countries in 1950 was converted into a deficit of 1,200 million dollars in 1956.
5. In considering the possible effects of the Free Trade Area on the European trade of non-member countries it therefore appears justified to concentrate attention on Western Europe's trade relations with the primary producing countries, leaving aside the issue of trade relations with industrial countries (mainly North America and Japan).

2. General trends in primary imports

6. It is not a new observation that imports of primary products into industrial countries, i.e. not only Western Europe, has tended to decline in relation to their industrial output. One part of the explanation is that technical progress has led to a substitution of many natural industrial raw materials by synthetics. Another is the self-sufficiency policy as regards food products pursued by most West European countries in the last twenty-five years, coupled with the slower rise of demand for food-stuffs than for manufactures. The effects of these factors have been balanced, but only partly, by a marked increase in imports of certain other raw materials, notably mineral fuels and metals. Thus, for Western Europe, the period 1952-1956 showed a 20% increase in imports from primary producing countries comparing with an increase of 33% in total imports.
7. The composition of West European imports from primary exporting countries has undergone considerable changes as a consequence of these long-term trends. Food and agricultural raw materials which in 1925-28 and 1934-38 accounted for 95% and 90%, respectively, of the total, had by 1956 declined to 70%; simultaneously petroleum had risen from 3% to 19% and other minerals from 7 to 13%.
8. These changes have been accompanied by important geographical shifts in the origin of primary imports, the share of the petroleum and mineral exporting countries having increased sharply at the expense of countries exporting mainly foods and other agricultural commodities. In particular, Latin America's share of those imports has declined from 35% in 1928 and 28% in 1937-38 to 21% in 1956, while the share of the overseas sterling area³ and other affiliated areas⁴ increased from 51% in 1928 and 57% in 1937-38 to 68% in 1956 (with the overseas sterling area accounting for four-fifths of this share).
9. As regards food—the most important group, with coffee, tea, cocoa, meat, grain, sugar and tobacco as chief items—about 45 % of Western Europe's imports from primary producing countries were supplied by the overseas sterling area in 1956, an additional 40% being equally divided between the other affiliated areas and non-dollar Latin America⁵. As regards raw materials, the share of the overseas sterling area was even bigger, 55%, with other affiliated areas and non-specified primary exporters sharing equally a further 30%. Finally, the

2. Including all Latin America, Africa, the Near, Middle and Far East, except Japan; and excluding Eastern Europe with U.S.S.R. and Mainland China.

3. Commonwealth countries (except Canada), British colonies, Burma, Iraq, Jordan and Libya.

4. Territories of France, Belgium, Holland and Portugal. Also Tunisia and Morocco.

5. Argentina, Brazil, Chile, Paraguay, Peru and Uruguay.

overseas sterling area provided 60% of Western Europe's fuel imports from primary exporting countries, mainly crude petroleum, while non-specified primary exporting countries supplied a little more than 20% and dollar Latin America about 13%

3. Future trade trends

10. Western Europe represents an expanding economy, and, looking ahead, the first step must be to enquire into the probable future development of European trade—quite apart from the impact of any Free Trade Area, including the Common Market.

11. The Economic Commission for Europe (E.C.E.) has attempted an evaluation of West European import requirements of primary products up to 1975 on two alternative assumptions relating to the rate of economic growth in this area. The first (I) implies an increase of gross national product by 60% in 1975, the second (II) an increase by 100%; more particularly agricultural production is assumed to rise by 30% in the first alternative and by 35% in the second. Under the first alternative the volume index of West European import requirements in 1975 would stand at 130 (1954-56 = 100), under the second at 170.

12. As regards the main categories of primary goods these projections result in the following changes in West European import requirements by 1975:

13. For foodstuffs an increase by 10% under Alternative I and 30% under II. (Under I the whole increase would be confined to tropical beverages, tobacco and vegetable oils and fats; under II, also meat, grain, sugar and fruit would register substantial increases).

14. For mineral fuels the increase for petroleum would under Alternative I be 40 % and under II 150%, while for coal the increase is in both cases estimated at 70%. For minerals, ores, etc., both alternatives reckon with sharp increases (by many hundred per cent) for such items as iron ore, aluminium, zinc.

15. In summary, under Alternative I the outlook for exporters of foodstuffs and agricultural raw materials are distinctly unfavourable and even under the more optimistic Alternative II they do not appear very bright. As regards the future regional distribution by origin of Western Europe's imports of primary goods, the E.C.E. estimates that under both alternatives the dollar countries of Latin America, the dependent overseas territories and certain Asian countries would benefit most, more than doubling their export earnings in Western Europe. For nondollar Latin America and the overseas sterling area—essentially producers of foodstuffs and agricultural raw materials—the expansion would be appreciably lower.

4. Impact of the Free Trade Area

4.1. Economic Growth

16. To what extent will the extrapolations summarised above be influenced by the Free Trade Area

17. The answer will depend very largely upon the effect of European economic integration on the rate of economic growth. The ratio of imports to industrial production is high in Western Europe—30% as compared to 9% in U.S.A.— and, what is more, appears relatively stable; hence, the higher the rate of growth, the higher the level of imports. Moreover, the trade-diverting effects of a free trade area would tend to be much less pronounced in a climate of rapid economic expansion.

18. The economic purpose of the Free Trade Area, as well as of the Common Market, is precisely to secure the most rational use of productive resources and thus to accelerate the rise in living standards. But both schemes envisage a gradual and orderly introduction of new competitive conditions with adequate safeguards to mitigate social hardship and general economic difficulties of adjustment. The economic benefits of integration may therefore be attenuated by considerations of social as well as of national interest, especially during the earlier phases of the transitional period.

19. This holds true particularly as regards the more rational utilisation and redistribution Of manpower and the freer flow of capital among member countries. Likewise, in agriculture, substantial productivity gains might be obtained by increased competition and international specialisation but the weighty considerations militating against any vigorous drive in this direction are too well known to require elaboration.

20. With these considerations in view,, one may perhaps, with all due reservation, ask whether economic integration will be able to bring about more than the doubling of gross national product by 1975, foreseen under E.C.E.'s optimistic Alternative II. It may be mentioned that E.C.E. arrives at this more favourable

projection principally by assuming a higher rate of labour transfer from agriculture into industry, accompanied by an increase in the gainful employment of women; it is also assumed that unemployment will be greatly reduced, particularly in the South European countries. These assumptions turn precisely on the critical issues on which even the Free Trade Area and the Common Market may find it most difficult to make headway.

21. As the changes in production brought about by integration would not seem likely to result in any substantial changes in Western Europe's net requirements of primary products, the 70% increase in primary imports projected by the E.C.E. may therefore be taken as the best estimate available. This is clearly an important conclusion.

4.2. Trade Patterns

22. The second main problem is to what extent and in what direction the Free Trade Area (and Common Market) will affect the commodity composition of European imports of primary goods and (or) the distribution by origin of such imports.

23. When discussing this issue, a significant preliminary question is whether the relative decline of primary imports in recent years reflects a diversion of trade due to the OEEC trade liberalisation programme. From 1951 to 1955 OEEC imports originating within the OEEC area rose by 4,000 million dollars, imports of outside origin by only 1,000 million dollars. As a result, intra-European imports rose from 39 to 45% of total OEEC imports. However, the strong increase in intra-European trade occurred mainly in manufactures, which traditionally form the bulk of this trade and the European share of manufactures imported actually remained unchanged at 76%. This clearly indicates that there was no significant diversion of trade during this period which was marked by a high rate of economic expansion. It also appears to confirm that the principal factors underlying the relative decline of West European trade are largely permanent in character.

24. As regards changes in commodity composition, it should be stressed that the ECE projections represent a straight extrapolation of present trends. Considering the points made earlier concerning the effects of the Free Trade Area, there would appear no reason to expect any substantial modification in these trends—although a quicker increase than postulated in imports of such goods as rubber, minerals and metals may be a likely possibility, while the unknown pace of nuclear energy developments renders the estimates for fuel imports particularly uncertain.

25. The trade-diverting effects may, generally speaking, be expected to be the less pronounced the higher the rate of industrial expansion in the Free Trade Area countries. Moreover, they will depend upon whether any overseas countries and territories are associated with the Free Trade Area or no such association is introduced.

26. On the latter assumption—at present the most probable one — a distinction must be drawn between the Common Market countries and other Free Trade Area countries.

27. As regards the eleven countries outside the Six, the imports of primary goods that are -exclusively (or almost exclusively) produced outside continental Europe are not likely to be affected by any significant diversionary effects. There is no European competition, and the abolition of tariffs between these countries—in any case low or non-existent in respect of many of the commodities in question—will hardly influence the choice of suppliers.

28. As for items which are produced in Europe, the abolition of intra-European tariffs will obviously create competitive advantages for European producers. As national tariff systems are retained vis-d-vis the outside world, however, there is no particular reason to expect any marked shift in import patterns. The principal products are fruit, wine, vegetables, dairy produce, meat, cereals, certain animal and vegetable oils and fats, tobacco, hides and certain fibres. Some of these commodities are produced in relatively small quantities and this situation is likely to continue. In the case of others, notably dairy products and meat, European production may be expected to expand at the expense of imports from such suppliers as Australia, New Zealand and certain Latin American countries. (Commonwealth exports to the United Kingdom might, of course, be cushioned against these effects by special arrangements).

29. As regards the Six, the establishment by the European Economic Community of a common external tariff at roughly the average of existing tariffs may lead to certain shifts in the volume of primary imports by individual countries, but will not necessarily result in any substantial change for the Six taken together, although different suppliers may be differently affected. Common Market producers will, of course, enjoy a competitive advantage within the whole Free Trade Area against imports from outside sources. Again with the exception of certain foodstuffs, the effects of the common tariff in diverting trade would probably be of limited consequence for primary exporters as a group.

30. Far more important in this respect is the association agreement with the overseas territories of the Six, by which their exports will be admitted into the Common Market on the same terms as are applied among the Six. This means extending the competitive advantages created by the Common Market to almost the whole range of primary products coming from the sub-tropical and tropical regions. Thus the associated overseas territories are important exporters of cocoa, coffee, bananas, tobacco, oil seeds and vegetable oils, cotton and tropical timber. They also produce tea, sisal, sugar, as well as bauxite, copper and iron ore.

31. In most cases the Six take the bulk of the exports of these territories, but in no case do these exports account for more than half the combined imports of the Six of the commodities in question. The extent to which traditional outside suppliers may suffer in their exports to the Six will depend largely on the level of the common tariff in comparison with existing duties. The rates already fixed by the Treaty for numerous items are in many cases substantial—80% for sugar, 35% for tea, 30% for tobacco, 20% for bananas, 16% for coffee and 9% for cocoa; for many of these goods those countries of the Six that have no overseas associates did not previously levy any duty at all. Moreover, most of these products are listed among the goods subject to the agricultural provisions of the Treaty which means that supplementary protection measures—minimum prices and long-term contracts—may be introduced.

32. The decline of exports to the Community may be offset by market gains elsewhere, if the associated territories do not increase their exports correspondingly. The Treaty, however, explicitly foresees the expansion of production in the territories—and more particularly creates a Development Fund to finance development projects. The order of magnitude of potential trade diversion can be summarily illustrated by two figures: exports of the associated territories to non-Six European countries in 1956 amounted to 100 million dollars while in that same year the Six imported 900 million dollars' worth of the same commodities from outside countries.

5. Conclusion

33. It results from what has been said in the preceding paragraphs that no exact forecast can be made as regards the impact of the Free Trade Area as such on West European imports of primary products. Quite generally, however, there would be good grounds for believing that this scheme will not entail any grave consequences for the trade interests of the primary exporting countries. Two points, in particular, stand out. In the first place, the Free Trade Area is likely to have an expansionist effect on the rate of West European economic growth—of fundamental importance for the volume of imports of primary products. In the second place, the Free Trade Area as such is not likely to produce any substantial disturbances in the existing pattern of West European primary imports; by contrast, it cannot be ruled out that the Common Market, with its association arrangements, will entail shifts in supply flows that may significantly affect the trading interests of individual countries.

5.1. The position of Israel — a case-study

34. Following the more general observations in the above sections, an attempt will be made below to describe the implications of the Free Trade Area for the West European trade of one non-member country—Israel—whose economy is geared to that of Western Europe to an exceptional degree.

35. In the first ten years of its existence as a State, Israel has trebled its population, now almost 2 million, owing chiefly to large-scale immigration. During the same period there has been an inflow of capital to the tune of 2,500 million dollars—largely gifts, grants and reparation payments—which have made it possible to finance import surpluses on trade account of more than 2,000 million dollars and to maintain the rate of net investment at 20% of gross national product.

36. Even though the economy of the country has experienced a high rate of growth, Israel in certain respects is still an underdeveloped country where much remains to be done to exploit its natural resources, to broaden its economic basis and render it independent of outside assistance. Industrialisation is under way and industrial investments today outweigh those in agriculture. To sustain this process will for some time require continued financial assistance from abroad. Large trade deficits cannot, however, continue indefinitely and the expansion of exports is therefore a vital matter.

37. Israel's imports in 1956 and 1957 were 367 and 432 million dollars corresponding to about 30% of national income and its exports 105 and 139 million dollars, respectively. About 66% of imports in 1956 were manufactures, the rest being shared between raw materials (21%) and food, drink and tobacco (23%). Agricultural products, almost exclusively citrus fruits and products thereof, dominate in exports with 46% of the total (in 1957), while the remainder is shared by industrial products (29%) and polished diamonds (24%).

38. The 17 OEEC countries accounted for 49% of Israel's total imports in 1956, with manufactures as the predominant category (112 out of 160 million dollars). For the Six, no less than 82% of their exports to Israel, were manufactures, while the corresponding figure for the other 11 OEEC countries was 71%.

39. The same 17 countries in 1957 took 63% of total Israel exports (as against 58% in 1956). No less than two-thirds of these exports to the OEEC area were agricultural goods, the remaining one-third being divided fairly evenly between industrial products and polished diamonds. Among the OEEC countries, the United Kingdom stands out as the most important single market, accounting for almost 30% of total Israel exports to Western Europe.

40. Having regard to the present commodity composition of its exports to the OEEC area, Israel may for the present purpose be considered essentially a primary exporting country, dependent for the bulk of its European exports on one group of products, citrus fruit and citrus juice and preserves, marketed under a series of bilateral trade agreements.

41. While the earlier observations concerning Western Europe's future import requirements thus apply also to Israel's most important export items, it should be noted, first, that citrus fruit is among the foodstuffs that enjoy a relatively high income elasticity of demand and, secondly, that this product does not compete with the overseas territories associated with the Common Market. Broadly speaking, the Association Agreement may therefore be ignored here.

42. Oranges, tangerines and mandarines account for about 85% of Western Europe's imports of citrus fruit (as well as 85% of Israel's exports of citrus fruit). Total West European imports of these three fruits in 1956 amounted to 269 million dollars (179 million dollars imported by the Six and 90 million by the Eleven). About 11% of the total was supplied by Italy and 6% by Algeria, the bulk being thus imported from countries outside the Free Trade Area, with Spain, Tunisia, Morocco and Israel as main sources. Israel supplied about 31 million dollars worth—11-12% of total West European imports— of which 8 million to the Six and 23 to other OEEC countries.

43. The preference created by the Free Trade Area for these products will thus mainly benefit Italy and Algeria. These countries will not, however, within the foreseeable future be able to supplant outside producers. Moreover, competition among citrus fruit producers is reduced by the spread in harvesting seasons.

44. It therefore seems a fair conclusion that the prospects for Israel's main export product, citrus fruit, in Western Europe do not appear to be gravely threatened by the creation of the Free Trade Area as it is conceived at present. A very different situation would, on the other hand, arise if Spain, Morocco and Tunisia were, by one means or another, associated with the Free Trade Area or with the Common Market.