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ECONOMIC ASPECTS OF THE NATO ALLIANCE

by

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NATO—PROBLEMS AND PROSPECTS

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ECONOMIC ASPECTS OF THE NATO ALLIANCE

The North Atlantic Treaty provides in Article 2 a very broad framework for political and economic cooperation, with a view to promoting conditions of stability and well-being and to eliminating conflict in international economic policies. However, very little has been done in this respect. The report of the "Three Wise Men" of 1956 broadly describes the aims which such actions should pursue: more freedom in trade and capital movements; better coordination and more effectiveness in aid to developing countries. The last objective named is of a broader character—that of building a good base for the working of free institutions. It recognizes that duplication with other institutions has to be avoided, particularly with the functions of what was then Organization for European Economic Cooperation (OEEC), and which has developed into Organization for Economic Cooperation and Development (OECD) through full American and Canadian membership.

In NATO itself, one may assume in all fairness that the main economic question which is directly dealt with is the capability of each member country to take its share of defense and armaments expenditure. This is an exercise which was started on the eve of the Lisbon conference of 1952.

The Problem of Interdependence

The striking feature of the NATO alliance is the enormous disproportion between the power of the United States and that of any other member taken in isolation. Even after the great progress made in Europe, the relations between the United States and any one of the largest NATO powers is that of eight to one. Britain, France, and Germany are roughly equal, whereas Italy, with about the same population, and despite its economic progress by leaps and bounds, is still lagging behind. The difference is all the more striking if one considers Canada, which of course has a very high production per head, but a reduced population, and even more so the smaller countries, whether fully industrialized or still in the process of development. In general terms, the United States by itself represents about one half of the population of the Atlantic world and much more than one half of its total production.

In matters of defense, nothing has as yet emerged to bridge this gap, unless one subscribes to the theory of the equalizing effect of nuclear force, however limited the European proportion in this respect. In economic matters, the imbalance begins to be redressed by the progressive establishment of a large European unit. The Community of the Six, despite more rapid progress since 1955 than has been achieved in the United States, still represents about one half the total American production, with a hardly smaller population. British entry into the Common Market would have further closed the gap. This would have given full significance to the concept of Atlantic partnership. Of course, partnership may describe any kind of association between members, large or small. The more imaginative policy is that of partnership between equals, which in the Atlantic world could only mean a relationship between two large units on both sides of the Atlantic.

Whatever the way this notion originated, it gained historic significance when proposed by President Kennedy in his Philadelphia speech on the 1962 anniversary of the Declaration of Independence. Of course it extended far beyond the field of economic matters to include defense and policies toward the rest of the world. Thus, beyond a recognition of a move toward economic unity in Europe, it was an appeal to political unity as well. In this respect, progress is very slow, if not completely halted. In the economic field, the grand design included support for the entry of the United Kingdom into the European Community, the possible adverse effect on American exports being however limited by all-round reductions in tariffs. This hope too has been disappointed.

In political terms, the importance of President Kennedy's offer was to recognize the difficulties which arise from the very disproportion between allies, the reciprocal resentment which this may lead to on the part of those who feel too dependent, as well as those who feel too much depended upon. It was also a wise recognition that great decisions and far-reaching policies should be discussed to avoid the risk which Keynes described in the preface to his general theory—how incredible it is what foolish things one may think when he thinks too long alone.

From an over-all point of view, this is not so much a concept opposed to that of an Atlantic Community grouping together a large number of nations as such, as a practical way of organizing it, and an answer to a dilemma. There is no lack of international statements suggesting that the Atlantic Community could be run by some kind of high council where a majority rule could at some point be introduced. It is not quite clear whether the implications have been fully thought out. Looking at the share of the United States in total population, production, contribution to defense etc., no democratic rule could force it to accept minority status. Now it is also a political fact that it would be inconceivable to give only one country veto, while other nations which consider themselves great powers could be overruled. It is this very nature of things which commends the creation of a large European bloc, and the organization of the Atlantic Community as a continuing process of closer relationships and joint action. In this respect, there is no other procedure than agreement between two parties. The rise of the European Community begins to give significance in the economic field to a notion of partnership which would serve two purposes: avoiding conflict and furthering common interests.

Too much has been made of the blow dealt to this grand design by President de Gaulle's refusal in January 1963 of the British bid to join the Common Market. The one immediate implementation of the partnership concept was the proposal to negotiate tariff reductions under the authority granted to the President by the new American legislation. Under no circumstances could it have remained a purely bilateral affair between an enlarged Common Market and the Americans. In substance, the task remains the same.

It could even be argued that a British membership in the Common Market raised, or at least manifested, some fundamental issues which could not have been resolved even in such a powerful group as an enlarged community. Thus the path which led to Atlantic negotiations through British membership in Europe could as well be reversed, and an approach made to these large-scale issues in the broader framework of Atlantic cooperation.

Agricultural, Aid, and Monetary Considerations

The first case is that of agriculture. The negotiations between Great Britain and the Common Market revealed two aspects of it. On the one hand, there is support given to the income of the agricultural producers on both sides of the Channel, however much it may differ in form. Continental Europe raises income by raising the price through old and new ways of protection. Britain brings down the domestic price to the level of imported goods by deficiency payments which make up for the difference between this and the guaranteed receipt to the home producer. But even more important, there was a kind of scramble for the British Market which revealed the acute limitation of solvent outlets for agricultural production in the world at large. Home producers wanted to keep it, the Common Market farmers were eager to get a new access to it, the Commonwealth continued to look at it as their privilege, and the United States began to wonder why it should be discriminated against in favor of the Commonwealth. Clearly, new and expanding markets must be found if freer trade is ever to be established in agricultural products.

The second glaring case is the problem of money. It may appear astonishing that it was not officially raised in the negotiations. The Community of Six has had no real monetary problems. None of those countries possesses a reserve currency, and all of them since the franc devaluation at the end of 1958 have enjoyed a surplus which avoided any difficulties in their balance of payments, even if now this situation appears to be deteriorating rather fast. The British case is just the reverse. The pound sterling is a world currency, used as a reserve by the members of a large trading area. Britain's dependence on foreign trade makes it very vulnerable to balance of payments difficulties as soon as its economy goes faster or its competitiveness weakens. There is no doubt that the British entry into the Common Market should have hastened the plans for some monetary arrangements between the members of the community, perhaps some kind of a common reserve fund.

Still more broadly the ties and commitments which Britain has in all parts of the world would have added a new dimension to the outlook of the community. The territories associated with the Common Market comprise less than sixty million inhabitants. Some former British African territories might have finally decided to accept an association which at first they had turned down. The links to the White Commonwealth and to such large countries as India and Pakistan would have come to the fore. It can be argued that a substantial part of day to day foreign policy has been transferred to the Community by the member countries, inasmuch as they have pledged themselves to develop a common commercial policy before the end of the transitional period. They would have been bound to take a broader view of world problems.

Agriculture, aid, and money are some of the fields in which neither Europe, nor the United States, nor Britain plus the Commonwealth, can solve the problems in isolation. The narrow gate to common action passes through the tariff negotiations based on the Trade Expansion Act. One will soon discover that tariff reductions are not enough, or even that they cannot be implemented, unless some understanding is reached which concerns agricultural policies, overall policies (aid and otherwise) toward developing countries, and finally a reinforcement of the money and payments system.

The U.S. Trade Expansion Act of 1962

Whatever developments it may imply or necessitate in the field of common policies, there is no doubt that the Trade Expansion Act up to now is the one concrete step towards an Atlantic partnership. There is no doubt either that it was conceived against the background of British entry into the Common Market. Roughly speaking, it contained two main provisions: a general authorization given to the Administration to negotiate a reduction across the board of tariffs up to 50 per cent of their initial level; the possibility of a further reduction, even down to zero, on products for which the United States and the Economic Community, as of the date when the reduction would apply, accounted for more than 80 per cent of total world exports excluding inter-community trade and those of Communist countries. The 50 per cent limit is discarded for tariffs below 5 per cent or on agricultural or tropical products on which obviously the effective limit will be the degree of agreement which can be reached on parallel or reciprocal policies by all parties concerned.

The 80 per cent clause was so calculated that it was practically void unless the British joined the Common Market. Incidentally, Canada had been forgotten as one of the possible partners in computing the Atlantic share of world exports. In the present evolution of negotiations, the practical exclusion of this clause has very serious consequences.

Not only is there an absolute limit to the reductions which can be negotiated by the United States, item by item, but within the broad authority to negotiate reductions, without limit on products for which suppliers outside the Atlantic area proper were not important or actual competitors, a whole array of flexible formulae could have been devised to try and match the reciprocal concessions or accommodate the difficulties of the other side. A rigid limit leads to a great rigidity in the solutions which can be applied.

There is certainly great misunderstanding in Europe over the American insistence on applying a linear method of reduction. The fact that the American tariff is much more differentiated than the European one is easily concealed by averaging broad or even smaller categories of products. If, however, more appropriate statistical methods are applied, there are a lot of peaks in the American tariff, and in the British and Japanese ones as well. The common external tariff being roughly the arithmetic average of the four principal existing tariffs, it appears by virtue of its origin much flatter. It is often thought on the European side that the reduction of all duties by the same percentage would practically eliminate the protective nature of the European tariff by leaving a great many positions very effectively defended on the side of the other main negotiating parties. This interpretation should be dispelled.

The three main motives behind the American proposal appear to be as follows. On the one hand there seems to be a somewhat misleading analogy with a method which has proved successful in the establishment of the European Common Market. A certain flexibility had been provided for in the elimination of tariffs with a combination of a minimum percentage on each duty at every stage of reduction, and a minimum weighted average; in fact, the linear method has been consistently applied. But it should be remembered that there is no stop before the complete reduction to zero, so that the path followed is of merely secondary or passing interest. When, however, one is bound to stop half way, the method will determine the final position, i.e., the resulting comparative structure of tariffs.

But much more important to understand is the wish of the U.S. Administration to avoid, by means of a simple and rigid rule, the pressure of private interests and organized lobbies. This genuine concern for a far-reaching solution may not be fully appreciated in Europe.

There is finally an all-decisive factor. Once the 80 per cent clause was in fact discarded by the exclusion of Great Britain from the Common Market, any solution, other than linear cuts, is bound to limit even more the reductions achieved and leave one even further away from a 50 per cent target.

Tariffs and Trade

To clear up some of the misunderstandings, it may be useful to distinguish two purposes in the lowering of barriers to trade. The traditional one is to obtain as much increased access to other people's markets as can be skillfully bargained. With this approach, reciprocity is roughly measured by the amount of increased exports which each party may be given. Weighting the tariff rates by the volume of trade is not meaningless. The great unknown is how much water there is in some of the rates: if they do much more than compensate for differences in cost, their reduction is purely nominal; conversely, the reduction of even very high tariffs may be a very substantial concession, in cases where costs are extravagantly high.

The other line of reasoning is to accept the liberalization of trade for the sake of rationalization, and the shift to more productive or competitive activities which it entails. From that angle, increased imports have a real advantage, and it is not unreasonable to accept a much more than proportional reduction on the highest tariffs, whether they conceal a large safety margin or cover up highly uneconomic production.

This second line of approach would give more Atlantic significance to the exercise and justify a certain degree of harmonization of tariffs. Additional arguments stem from three other considerations. It is a fact that as between industrialized countries there is a two-way trade in all fields; in other words, specialization applies within each industry, rather than between industries as a whole. It is a reasonable claim on the part of the industries concerned, if the market is to be opened up to their competitors, that their competitors' markets should equally be opened up to them on more or less similar terms. There is also the important case where the most formidable competitor may be a third country, particularly a developing one which in some sectors enjoys very low costs of production: a harmonization of tariffs between industrialized countries would spread more evenly between them the impact of cheap imports in such a case. Finally, whatever the way in which it may be precisely defined, there is always the fear of dumping—the main defense against it being the possibility of retaliation. If however one industry operates behind very high tariff walls, it gives the impression of an army in a fortress which may with impunity launch an attack on its neighbors!

In fact no clear choice is made between the two concepts. The consequence is that some compromise might be struck which will have at least the political appeal of apparent reciprocity. Even if it could be argued that the less differentiated a tariff is, the less protective it is, and the less it should be reduced, this is hard to sell to public opinion. Thus the hallmark of reciprocity would mainly be, between the main partners, the same over-all percentage of cuts on the existing tariffs. However, the difference in structure between the less differentiated and the more differentiated ones will be taken care of in a rather clumsy way on a basis of product by product disparities. The logic of harmonization would call for a deeper reduction of a higher tariff when on any particular product there is a large difference from the lower tariff. But because of the absolute limit of reductions authorized by the Trade Expansion Act, it will be the other way around: the lower tariff will be less reduced. Economically this leads to a rather queer consequence. Protection is less reduced by one partner, not because his competitive partner requires a high tariff, but because the other partner requires one. And, when the main supplier is a third party who has to overcome a high tariff in country *A*, he will again be penalized by having to overcome a less reduced tariff in country *B*. In fact this works only in principle and there will be more flexibility in the actual implementation. But as a final solution, it would make sense only if this exercise were considered a first step, and some more flexible legislation could be later adopted, or if the European Community could be enlarged in time so as to make up for the fact that the 80 per cent has practically no application. It remains to be seen also how far the parameter chosen to define the so-called disparities will take care of most of the cases which otherwise would have been produced as exceptions.

The difference between the Common Market and the scope of the Kennedy Round is clear.

On the one hand, there is complete elimination of all barriers to trade, which means a reduction to zero on the entire array of products. On the other hand, there is only a partial reduction of tariffs, with possible exceptions or limited rates of reduction. In the Common Market, complete final reciprocity is assured by the fact that all tariffs are eliminated in intra-community trade, whereas there is for all member countries the same difference between the zero tariff and the common external tariff applying to goods imported from third countries. Whether in a transitional period equal rates of reduction, which on initially different tariffs result in unequal absolute reductions, lead to reciprocity or not, can be safely ignored. In the present negotiations, however, a problem arises as soon as the process stops half-way without any certainty as to the range of goods on which the maximum reduction applies. The old bargaining is revived by the fears of the kind of tariff structure one will be left with at the end of the negotiation. What complicates the problem further is that there is not even a clear answer to the question of the average level of protection provided by each tariff. If it is weighted by effective imports, this gives a very distorted picture. The real weight of high tariffs is not the imports they allow but the imports they prevent. This method gives undue weight to the lower rates under which the bulk of imports come in. Should one then resort to a simple arithmetical average? This approach too is distorted since it will in fact be weighted by the number of tariff lines devoted to the different categories of products. The correct assessment should be based on a difference between the imports which would take place if tariffs were zero and the actual imports realized under existing tariffs. This would unfortunately involve impossible calculations about the market and its elasticities. The spread between high and low tariffs can be assessed more accurately, but again there is an impossible problem of weighting.

An overriding question however is one posed by the report of the Brookings Institution. This recognizes that the common tariff was not deliberately set high, that the arithmetic average could be a rather objective rule and has been corrected downwards by additional provisions. However, it maintains that due to the very fact of a Common Market the external tariff affords a higher protection than did the four separate tariffs previously. The argument can be summarized as follows. The relevant factor is, which of the four groups had in any particular sector the most competitive industry? The others will have to adjust to its cost level if they are to stand its competition. If the common tariff is higher than was the tariff of the country in which the most competitive industry was located, then the ensuing protection is higher than it was before.

What this really amounts to is to imply that the more productive and competitive an industry is, the higher its protection even if the apparent rate of the tariff is maintained or lowered. If this is just another way of saying that the increased competitiveness of European industry due to the operation of the Common Market is going to make the exports of other countries more difficult, this is a fair point. If however it is construed as an accusation of protectionism, then there is a hidden fallacy. If we take it to its logical conclusion, we could accuse of protectionism even a country which would have a zero tariff if its industries enjoyed low costs of production. Much more relevant would be to point out that tariffs should not be considered in isolation, but in conjunction with the rate of exchange and also in conjunction with relative prices. An undervalued currency is equivalent to a substratum of fixed customs duty, on the basis of which the different duties are established; it also affords a flat subsidy to exports. The same point detracts from some of the value of the arguments put forward by the European Community against the accusation of protectionism. It does not deny that intra-community trade has increased much more than the trade with third countries. It points out however that trade with third countries has increased very rapidly, particularly on the import side. In fact, imports have grown even more than total internal production. The difference between the rates of growth of intra-community trade and trade with third countries is obviously the effect of the Common Market. It does not necessarily mean that there is any diversion of trade at the expense of third countries. Increase in trade may be at the expense of the corresponding internal production in each of the member countries. But if the increase in imports from third countries has been accelerated in the course of last year, this is not proof of the liberal intentions or policies of the community; it may be simply related to an increase in prices which has outrun the corresponding increase in other industrial countries of the world, particularly in the United States. But inflation is the last thing a country or group of countries could boast about.

Agricultural Tariffs

Agriculture has always been expected to present the most difficult problem. Even if both the United States and the Common Market claim to be fairly liberal in their tariff and import policy, this is a field where neither can disclaim guilt. There is no denying that the difficulties have their political side. It will be fascinating to see whether the redistribution of constituencies according to the ruling of the Supreme Court will make any difference! But the genuine problems cannot be ignored. The demand for most agricultural products is less elastic in relation to the increase in income than for manufactures or services. In other words, markets are limited. At the same time, technical progress has proceeded very fast. The theoretical solution is to reduce the number of people employed on the land, so as to raise their productivity and their income. But for human and social reasons this displacement cannot exceed a certain yearly rate.

At that rate, productivity increases fast, so that total production is not decreased but stepped up. Hence all the devices to maintain the farmers' income. Unfortunately, they almost inevitably distort the pattern of production and lead to the accumulation of surpluses, at the same time as some products, the market for which expands much faster, like meat, remain in comparatively short supply.

There is some justification in the approach offered by the European Community, i.e., to look into the amount of support which each product enjoys in different countries. Free trade only leads to a better allocation of resources when it is based on costs of production, not on competition between public treasuries. The support can take the form either of outright external protection, as in the Common Market, or of subsidies in proportion to production, as in Britain, or acreage limitations accompanied by payments to those who refrain from producing, as in the United States. However, the community's proposal is only to freeze the amounts of support, not to reduce them.

It is abundantly clear that, unless some new policies are devised in common, agriculture will be a stumbling block. The Common Market maintains at the same time that its own agricultural policy must be determined before negotiations get really started and that the problem can only be solved in a worldwide framework. As of now, there is only a verbal reconciliation between these two tenets, through an appeal to international agreements concerning prices, production, and outlets. But it remains to be seen what the content of such agreements will be. This is clearly a case where joint action shall not mean a compromise between the behaviors of various governments, but an attempt to devise some better ways to open new markets, adjust production to demand and maintain the income of the farmers.

Unless we act together, the West could miss an historical opportunity and fail just where it could best demonstrate its capacity to face the needs of our world. There is in this world a tragic contrast between our countries burdened with surplus production and the hungry masses of so many continents. There is also a contrast between our capacity to overproduce and the inability of the Communist countries to step up their agricultural production. To be sure, a part of the surplus is already distributed in kind to some other developing countries. However, price policies and not demand determine the output, and this form of distribution maintains the rigidities of production. It is high time for all of our countries acting together to discover some more flexible way of helping the hungry, so that they get what they need and we produce what is wanted, instead of letting them get what is not wanted.

NATO Economic Policies: Impact on the Rest of the World

Thus, an important fact emerges. What begins as a settlement of reciprocal relations between Europe and the United States is bound to develop into a policy in regard to the rest of the world. This is clear in the case of agriculture. It is equally clear with industrial tariffs, which by virtue of the most-favored-nation clause, would be applicable to third parties as well. How far, acting together, we are prepared to accept gradually more of the goods which developing countries should be able to produce, will be the yardstick of our capacity for consistent action. It would be inconsistent to give aid for purposes of industrialization and then to close the markets to the resulting industrial production. The developed countries must follow this course jointly, so as to spread the impact of what in some cases may be formidable competition. But provided the process is gradual enough, and full employment is maintained in our own economies, it is again, not a loss, to redeploy our own resources towards more productive use and more sophisticated lines of production.

Freer trade, a formed agricultural policy, a more consistent and effective over-all policy towards developing countries—all these require a high degree of employment and economic growth. This in turn requires a reasonable degree of price stability, in the absence of which expansion has periodically to be curbed, so as to avoid inflationary developments or disequilibrium in the balance of payments.

If freer trade is going to be established and maintained, then the autonomy of financial policies is going to be reduced, and more coordination will be necessary. In fact, the freedom which has to be abandoned is the freedom of making nonsense! Accelerated growth by concerted policies would make freer competition more readily acceptable. The larger swings in trade as well as the unequal development of imports under the influence of changes in prices and of the rates of internal expansion will call for greater and better administered credit facilities.

There is no lack of recognition of the various problems which this analysis has revealed step by step. What is lacking is the will to tackle them in their interrelationships instead of dealing with each of them in a dispersed and haphazard way. It is mostly from that point of view that the rejection of British entry into the Common Market has to be deplored. We missed the opportunity to set up effective instruments of coordination in the trade and economic policies on the two sides of the Atlantic in the form of original institutions which would have embodied the concept of partnership between equals.

This should not deter us from thinking further about what we can do for our own people. There is still a great deal that we can learn about each other and, even more from each other. There are still many misconceptions everywhere, even in Europe, about the working of the American economy, though it has by and large probably achieved a greater degree of equality than most other countries. It should even be stressed that the United States tax system accomplishes a greater redistribution of income than is the case in some of the countries where socialists have influence or have on many occasions run the government. Take only one example: capital gains are in most cases tax free in the hands of individuals in Europe, whereas they have been taxed for a very long time in the United States.

On the other hand, there are a great many misconceptions on the American side of the Atlantic about the development of social services in Europe and elsewhere, or on the role of planning. The fear that development of social security would reduce the competitive thrust in the economy and retard economic expansion has been proved wrong by the experience of many countries as different as Japan, Italy, Germany, and France. State or mixed enterprises, totally or partly owned by the government, may be run effectively or in some sectors may even offer a capacity for rationalization that surpasses the record of public utilities when privately operated. Finally, the insistence on the economic advantages of the free enterprise system may be somewhat overdone. There is no denying that it ensures the quality, the diversification and the inventiveness of both goods and services, as well as an effective allocation of resources. But such considerations are static in character. It is demand (including investment) rather than the allocation of resources that really determines growth and a rapid rate of expansion. Some flexible forms of planning may bring about a convergent effort towards higher production targets by all interested parties than would have been possible for each of them in isolation.

The Challenge for the Future

We are all slow in recognizing that in the last twenty years we have developed a completely new economic system which has as yet no name in history. The first discovery was that our own markets can be indefinitely increased, so that any form of imperialism should be abandoned not only on moral and political, but on economic grounds. Full employment eliminates exploitation by raising the remuneration of labor. During the 1930's, it might well have been doubted whether the West could be capable of such a rate of growth as was evidenced by Soviet communism. Now, with some setbacks, we have entered a phase of rapid expansion and practically mastered the recessions which were considered the almost inevitable plague of a free economy.

But all this is not enough. Freedom itself is not enough. It will not be maintained unless we are able to hold the promise which for almost two centuries has been considered just as much of an essential element of democracy: this is the search for equality. Equality has to be more precisely defined, and reconciled with the requirements of increased production and the necessary incentives to effort and to risk-taking. What it means is mainly two things. First, a minimum coverage of the essential needs, not only for those at work, but also in old age and illness. This cannot be achieved by proclamations, but only by a formidable effort to increase overall production. Now we have become rich enough to conquer poverty. The other meaning is very adequately covered by the concept of equality of opportunity. There was a time when the spreading of education could appear to run counter to the structure of the economy, where the predominance of manual jobs limited the outlet for skill and knowledge. Now has come the time when the progress in production depends on the progress of skills, which in turn can only be developed on the basis of general education. The requirements of economic efficiency thus coincide with the requirements of social justice.

We have to recognize that none of our countries lives up to this obligation. None of our systems of education, different as they may be, as yet realizes completely the principle of equal access, on the basis of ability, nor reconciles the spread of education with the maintenance of its cultural level. On all this we unjustifiably lag behind some of the Communist countries. It is a matter not only of devoting more resources to this task, but also of inventing new structures and new techniques which alone can reconcile the quality of culture and its wider distribution. Our future lies not in the diversity of the gadgets which we put on the market, but on our continued ability to apply in our policies, and to implement in our organization, the principles which in the past have too often been belied by our actions.