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Problems of Economic Union: The Benelux Experience
Frederick R. Dahl and Elinor Harris — 24 pages

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Introduction

Sunday, September 5, 1954 marked the tenth anniversary of the signing of the Netherlands-Belgium-Luxembourg Customs Convention which proposed a customs union among the signatories as a preparatory step towards economic union. In the intervening ten years, the initial optimistic expectations for the "Benelux" experiment had been replaced by a more cautious -- and in some quarters an extremely pessimistic -- attitude. Some progress towards economic union was made during the early period: a tariff union was constituted as of January 1, 1948; beginning in 1950, intra-Benelux trade -- with the important exception of most agricultural products -- was progressively freed of quota and exchange restrictions; and much was accomplished in the unification of excise taxes within the Benelux area. But the Economic Union, which was to have been inaugurated on January 1, 1950, was indefinitely postponed and has yet to come into effect; it was replaced by a so-called Pre-Union which was to last while the partner economies were to be further aligned and their commercial and financial policies further coordinated.

The principal reason for the slow progress during the early years was that the member countries sought to solve jointly the problems incumbent in an economic union at a time when their national economies were undergoing substantial and quite different readjustments to postwar economic conditions. At the time of the signing of the Customs Convention, it was assumed that the proposed economic union would be formed by countries in approximately equivalent economic positions. The longer occupation of the Netherlands and the attendant greater destruction, however, destroyed the basis for this assumption: the end of the war found the member countries in extremely unequal positions. 1/ As a consequence of this development and of the differences in the political and social climates of the Benelux countries, dissimilar economic and financial policies were followed by Belgium 2/ and the Netherlands in the early postwar period. In the latter country, a vast apparatus of direct

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1/ It has been estimated that the Netherlands lost 30 per cent of its national wealth during World War II compared with 8 per cent for Belgium; the losses of Luxembourg were roughly equivalent to those of the Netherlands: F. Baudhuin, La Belgique et la Hollande (Paris 1950), pp. 71 and 136, quoted in F. Gunther Eyck, "Benelux in the Balance", Political Science Quarterly, March 1954, p. 62. Jean van der Mensbrugghe, Les unions economiques (Brussels 1950), pp. 38-40, quotes similar estimates.

2/ In this paper, "Belgium" refers to the Belgium-Luxembourg Economic Union, the monetary and commercial policies of which are under Belgian control.

government controls was utilized to restore production and at the same time to restrain inflationary pressures. More favorable conditions in Belgium enabled that country, after a vigorous monetary purge, to attain quickly internal and external equilibrium and to restore the essentials of a free market economy.

Since 1951, the Netherlands has achieved internal financial stability and has corrected the imbalance in its external payments. This improvement has been accompanied, moreover, by the relaxation or abandonment of many direct controls in favor of more traditional methods of government regulation. Belgium, during the same period, has been able to maintain the financial stability and relative freedom from direct controls which have characterized most of its postwar experience. Consequently, the economic positions and policies of the Benelux countries have tended to converge in recent years. The conditions for closer economic union being thus more nearly met, the Benelux nations in this period have renewed their efforts to effect the union, and some progress in that direction has in fact been made. Fundamental problems -- some of which had previously been concealed by abnormal postwar conditions -- still await solution, however, and the question of whether full economic union will ever be achieved still remains in the balance. 1/

I. The Coordination of the External Economies of Benelux

Differences in the external payments and reserve positions of the member countries hampered closer Benelux integration for most of the postwar period. From the end of the war through 1951, the Netherlands incurred huge trade and payments deficits as a result of its investment and reconstruction programs, the presence of inflationary pressures within the economy, the financing of a "police action" in Indonesia, and a deterioration of its terms of trade. Conditions in Belgium, meanwhile, were nearly the reverse: its external payments generated consistent surpluses; inflationary pressures had been largely eradicated by a monetary purge in 1945; and cautious monetary and fiscal policies helped to maintain internal and external equilibrium.

1/ Considerable literature on the early period of Benelux is readily available, while the literature of developments since 1950 -- in English, at least -- is considerably sparser. Consequently, the treatment here will concentrate on the latter period. For the early years, see the summary of William Diebold Jr., Trade and Payments in Western Europe, (New York 1952), pp. 319-353, or the more technical study of Jean van der Mensbrugghe, op.cit. Sundry issues of the Amsterdamsche Bank Quarterly Review have treated individual developments. F. Gunther Eyck, op.cit., presents a general review of Benelux developments through the end of 1953.

As the result of this disparity, the coordination of Benelux trade and payments policies suffered. A common Benelux tariff was instituted in 1948; but in respect to quantitative trade and exchange restrictions, the members' policies were governed by their different balance-of-payments and reserve positions: the Netherlands maintained strict restrictions over all external payments while Belgium with its more favorable position followed more liberal policies. For this reason, the Ostend agreement (1950), to coordinate import and export policies and to conclude joint trade agreements beginning in 1951, had to be suspended.

Although tariff barriers within Benelux were abolished in 1948, these differences in trade policy prevented the full freeing of intra-Benelux trade from quantitative restrictions and the liberalization of payments within the area. Until 1950, the liberalization of trade within Benelux was governed largely by the degree of each partner's fulfillment of the OEEC liberalization program for intra-European trade; in that year, however, a beginning was made in liberalizing intra-Benelux trade to a greater extent than trade with other areas.

In the second half of 1951, a striking reversal took place in the Netherlands external payments position. A restrictive internal policy combined with the end of the world-wide raw materials boom and the fruition of earlier investment programs eliminated the deficit in the balance of payments. Since mid-1951, large global surpluses have been registered; the Netherlands became a creditor in the European Payments Union; and even its balance of dollar payments has shown a surplus. The Netherlands payments position thus became similar to that of Belgium which had maintained surpluses of varying magnitude in its global balance of payments and attained approximate balance in its EPU and dollar accounts.

The international reserves of the Benelux nations are now approximately equal, both in terms of absolute magnitude and in relation to foreign financing requirements. With the improvement in its external payments, the Netherlands has been able to accumulate gold and foreign exchange and thereby to replenish its international reserves. Belgium, on the other hand, has maintained its foreign exchange holdings at their previously attained high level by virtue of its continued favorable current payments position. 1/

1/ At the end of 1953, the Netherlands reserves of gold and foreign exchange totaled $1,167 million and those of Belgium totaled $1,090 million; for both countries about 80 per cent of these reserves were in gold and dollars. The ratios of gold and foreign exchange reserves to annual imports were also approximately equivalent, 45 per cent in Belgium and 49 per cent in the Netherlands.

The improvement in the Netherlands payments and reserve position enabled the country to relax its restrictions on trade and payments and thus to move closer to the Belgian policies. 1/ As the discrepancies in trade and payments policies were being narrowed, the Netherlands in February 1952 proposed the coordination of Benelux foreign economic policies, including a common Benelux quota in the EPU, the establishment of a common official body for the conduct of trade and exchange policy, and the mutual convertibility of Benelux currencies. The reply of the Belgian Government termed the proposals premature and stressed the necessity of the further coordination of internal policies leading to the free circulation of capital and of the integration of the price and wage structures of the Benelux countries. This reply marked a turning point in Benelux negotiations: henceforth the chief issue was not to be the Netherlands balance of payments problem but the problems growing out of the wage-price question.

The continued improvement in the Netherlands external position and the further relaxation of trade and payments controls during 1952 and 1953, however, led to renewed consideration of a common foreign economic policy for the Benelux countries. The work culminated in the signature of a protocol in December 1953 for the conclusion of common trade and payments agreements with third countries. 2/

Early in 1954, moreover, agreement was reached among the Benelux countries for the coordination of policies concerning quantitative restrictions on imports. In March and June 1954, the Benelux countries put into effect common lists of commodities that could be imported without restriction from the EPU and dollar areas. With few exceptions the two lists are identical and in effect they abolish discrimination against dollar imports.

1/ The liberalization of the Netherlands trade with the EPU area reached 92 per cent in May 1953, approximately the same percentage as that previously achieved by Belgium. Restrictions against dollar imports were formally relaxed for the first time in the fall of 1953. Invisible payments have been liberalized and free foreign exchange markets with the possibility of arbitrage established. Restrictions on capital payments have also been relaxed almost to the same extent as in Belgium.

2/ This protocol has yet to be ratified by the national parliaments; technical discussions on the implementation of the protocol, however, are currently in progress. The joint negotiations will apply only to those goods which circulate freely within the Benelux area.

Recent closer cooperation in the field of trade and payments has resulted in the Benelux countries' acting more frequently as a unit in international conferences. An example of this development was to be found at the recent conferences in London on convertibility where a single delegation, headed by the Netherlands Minister of Finance, represented the Benelux countries. Previously, joint delegations had been sent only to conferences of the Contracting Parties of the GATT.

The degree to which the Netherlands and the Belgian external positions and policies have been aligned is perhaps best illustrated by their respective approaches to the subject of currency convertibility. Dr. Holtrop, in the latest annual report of the Netherlands Bank, states: "From a technical monetary point of view, the Netherlands can indeed be regarded as standing on the threshhold of convertibility." In the latest report of the National Bank of Belgium, Governor Frere reaches a similar conclusion: "The Bank thinks it has established during recent years the necessary prior conditions for the institution . . . of a genuine convertibility of the Belgian franc. . . ." Both banks view "convertibility" as the ability of both residents and non-residents to exchange guilders or Belgian francs for any currency whatsoever, and agree that such a convertibility should not be frustrated by import restrictions. The two countries differ only in respect to the treatment of capital: Belgium envisages convertibility on both current and capital account; the Netherlands, on the other hand, favors -- for the present, at least -- continued control over capital movements. 1/

In sum, the past year has seen real progress by the Benelux countries in coordinating their foreign economic policies. This development has had two major consequences: first: it has enabled the countries to act as a unit in international conferences on trade and payments; second, it has removed the balance-of-payments objection to the complete freeing of intra-Benelux trade. As a result, attention has now been focused on the problems of necessary internal adjustments: the alignment of costs and prices, the reallocation of factors of production, and the coordination of domestic economic policies.

II. The Coordination of Internal Financial Policies of Benelux

The restoration of internal financial stability in the Netherlands as well as in Belgium has helped not only to coordinate the external economies, but also the domestic economic policies of Benelux. Such coordination, at least in the sphere of monetary and fiscal policies, has long

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1/ It is unlikely that either the Netherlands or Belgium, separately or jointly, would undertake alone to make their currencies convertible. Such a decision would undoubtedly await at least the achievement of sterling convertibility.

been considered a prerequisite to the attainment of economic union. Without such coordination there would be some danger of divergent policies in the attempts of the member countries to mitigate cyclical fluctuations and to lay the basis for stable economic growth.

A. Coordination of Monetary Policies

The monetary policies of Belgium and the Netherlands were diametrically opposed prior to 1951. Between 1945 and 1950, the Netherlands maintained artificially low rates of interest in order to stimulate public and private investment, especially for the sake of rehabilitating war-devastated industries; in contrast, Belgium used tight monetary policies to absorb excessive liquidity and to stave off inflationary pressures.

Most of these earlier extreme differences have disappeared. The Netherlands monetary authorities still seek to maintain easy money and capital markets in order to promote investment, production, and employment, while taking precautionary measures against any revival of inflationary pressures. The Belgian National Bank continues to emphasize the need for restricting investment to the volume of "genuine domestic savings" and foreign loans. It continues largely to adhere to the doctrine that expansionary policies would be reflected in higher costs (and prices) in the export industries and would thereby undermine Belgium's international competitive position and its external balance. However, such differences of opinion as still exist are to a greater degree than formerly matters of emphasis rather than of principle, and the rigidity characteristic of postwar Belgian monetary policies appears to have been relaxed somewhat during 1954. 1/

Since the beginning of 1954, in fact, both countries have been using more similar central banking and debt management techniques. In Belgium, strict primary and secondary reserve requirements -- amounting to 65 per cent of bank reserves on the average -- have been effective throughout the postwar period. The Belgian authorities have also consistently placed great emphasis on consolidating the "floating" short-term public debt into longer maturities, but at the same time they have recently reduced progressively the rates on long-term public bond issues. In order to meet rising budgetary deficits, they have also quite recently, for the first time, permitted the commercial banks to subscribe to long-term Government bonds, instead of confining them to the purchase of short-term issues.

1/ These changes and other details of recent monetary and debt management policies in recent years may be found in a paper by Frederick Dahl, "New Reserve Requirements in the Netherlands", March 24, 1954; and in two papers by Elinor Harris, "Government Debt Management and the Capital Market in Belgium", April 21, 1953 and "Belgian Progress Toward Convertibility", July 20, 1954.

Similarly, the Netherlands early this year instituted primary (or cash) reserve requirements up to a maximum of 15 per cent, designed to immobilize excess bank reserves created by balance of payments surpluses. Quantitative credit controls in the form of secondary reserve requirements were first introduced in 1951 to supplement disinflationary fiscal measures and wage policies, but were withdrawn in 1952 as inflationary pressures declined and domestic activity slackened. Preparations were also made in March 1954 for the introduction of secondary reserve requirements consisting of short-term Treasury securities, should the need arise. Finally, the excessive liquidity of the Netherlands banks was reduced in the spring of 1954 by the conversion of a large portion of short-term bank-held government securities into medium-term bonds.

Thus both countries have not only a similar administrative and technical framework of central banking control, but also less disparities in their short and long-term interest rates than earlier in the postwar period. These disparities were narrowed further with the establishment this summer of the common Benelux capital market. 1/

The increased similarity and wider variety of monetary techniques within Benelux, including reserve requirements as well as the discount rate, permits similar control of disturbances arising in the foreign as well as the domestic sector. At the same time, the maintenance of separate monetary control authorities will permit each partner, should the need arise, temporarily to protect itself from possible adverse effects of overly expansionary (or overly restrictive) policies of the other.

B. Establishment of a Common Capital Market

The increased similarity to be found recently in monetary policies of the Benelux partners has been followed by closer alignment of their money and capital markets. In July 1954, most capital transactions between Benelux residents were freed from legal restrictions, although major practical obstacles remain to obstruct the free flow of capital, such as market imperfections and differing tax treatment of capital yields. Belgian and Netherlands nationals may now float new equity or bond issues in the capital market of the other country; short-term bank credit may flow without restrictions between the Brussels, Amsterdam, or other local money markets; and capital may

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1/ The differential between yields on public Belgian and Netherlands bonds in October 1954 was a little less than 1 per cent while in July 1954 it stood at about 1 per cent and in December 1948 at 1 1/2 per cent.

be repatriated from the territory of one partner to that of the other. The transfer is made through a free Benelux exchange market at freely fluctuating rates of exchange. 1/

For some time previously, Belgian nationals had been authorized to make unlimited capital transfers both to the Netherlands and to other EPU nations. In fact, it was always possible for Belgian residents freely to transfer funds even to the dollar area although at the slightly higher free-market dollar rate of exchange prevailing for the so-called "security dollars". The new regulations therefore have represented greater easing of the Netherlands than of the Belgian capital controls.

Although payments for current trade transactions between the Benelux nations will continue to be effected at the official exchange rates, payments for certain non-commercial current transactions (services, travel, transfer of profits and interest) may be made either through the official or the free guilder-franc market. This provision tends to narrow the differential between free and official exchange rates. The Netherlands and Belgian National Banks have also arranged for possible intervention in the free market, if necessary, to avoid "disorderly" rate fluctuations.

Interest rate differentials — The question arises whether the postwar Benelux interest rate differentials will tend further to be narrowed, or possibly eliminated, through creation of a common capital market. Even more important is the question whether there will be, in fact, a sizeable capital flow from one Benelux partner to the other; and if so, whether the flow will be from the Netherlands to Belgium in response to prevailing interest rate differences; or from Belgium to the Netherlands in response to possibly more dynamic long-range growth prospects in the latter.

1/ The mechanics of the new Benelux capital market are somewhat as follows: a Belgian citizen may now instruct his exchange broker in Brussels to buy or sell Benelux securities on the Amsterdam capital market; to transfer Belgian francs for their purchase, at the free rate of exchange, from his Brussels bank to the Amsterdam dealer; or to transfer guilders arising from the sale of previously-held Netherlands securities into Belgian francs, also at the free rate, for deposit in his Brussels bank account. Dealers will be free to conduct arbitrage operations in the free-rate market. Thus a free market in transferable Belgian francs has been established in the Netherlands and in transferable guilders in Belgium.

Belgian money market rates and bond yields have been generally higher than comparable Netherlands rates because of tighter postwar Belgian monetary policies restricting the supply of credit and growth of domestic investment funds. The changes since 1951 both in the Belgian and in the Netherlands external balance, with the corresponding effects upon the internal credit base, have tended to reduce differences in liquidity of the two economies, however. Moreover, in the last year, Belgium has relaxed its credit policies and attempted actively to reduce the public and (indirectly) the private rate structure, through permitting greater ease in the money market, while the Netherlands has acted to absorb excess bank reserves. Nevertheless, a complete unification of interest rates throughout Benelux is not to be expected as long as a uniform currency is not established and a double exchange market (with its resultant risks and inconveniences) continues to function; 1/ nor as long as Governors of the two central banks continue actively to desire independence of action with respect to the creation of reserves and of private credit supply.

Continued differences in the supply of and demand for capital in the presence of market imperfections also operate against complete interest rate unification in Benelux. In the absence of complete mobility of capital, equalization of domestic capital supply in the Benelux partners is further hampered by differences in savings habits and investment preferences. Similarly, capital demand varies because of varying regional and national industrial prospects and needs. Finally, the normally greater propensity to invest in local industry, reinforced by political and business pressure, may further obstruct the flow of capital within the Benelux area. Even under the most ideal circumstances, therefore, the movement of capital funds within the Benelux area will apparently be too sluggish either to wipe out the interest rate differentials or to deprive the Benelux central banks of their independence of action.

1/ For instance, as a result of the capital flow from the Netherlands to Belgium in August and September 1954, the free market rate for the Belgian franc in early October was about 2 per cent above the official par value. From the viewpoint of the Netherlands investor, therefore, the exchange rate mechanism has tended to wipe out some of the actual yield differentials between Netherlands and Belgian securities without, however, any comparable change in the interest rate differentials in the local currencies of the two countries.

The flow of Benelux investment funds -- Initially, the movement of capital funds has been from the Netherlands to Belgium in response to the current higher rates of interest on Belgian bond offerings; the present 3 3/4 to 5 per cent coupon rate on Belgian bond issues floated in the Amsterdam market is about 1 to 1 1/2 per cent higher than that on comparable Netherlands offerings. 1/ Such a movement tends further to tighten credit and the supply of bank reserves in the Netherlands and, at the same time, to provide an external outlet for surplus investment funds at higher yields than could be obtained internally in the Amsterdam market. Similarly, Belgium gains additional capital needed to raise the level of net new Belgian investments to that of other Western European countries, without any added strain on the internal money and capital markets or any burden on Treasury financing. 2/

Despite the rate differential and the early success of Belgian bond offerings, it is not clear that the capital flow from the Netherlands to Belgium will be very heavy in terms of the Belgian great requirements for capital funds. In July, a Belgian Treasury long-term issue of Fl 100 million of 3.75 per cent bonds was indeed several times over-subscribed on the Netherlands market; its success has induced Belgian municipalities to open negotiations with Netherlands investment trusts and banking institutions for loan flotations on the Amsterdam market, at an interest rate of about 3 3/4 per cent. 3/ Whether Belgian corporate debentures, which entail more risk than guaranteed Treasury obligations, will be similarly successful is somewhat more problematical. 4/

1/ Moreover, the Belgian public lottery loans, in contrast with the Netherlands issues generally quoted in Amsterdam at a high premium over the issue or redemption price, not only offer a higher yield but are practically all quoted around or below their redemption price.

2/ In view of the one-sided flow of Benelux capital transactions in the first four months of operation of the common capital market, the Belgian "L (capital) account" franc has undergone an almost uninterrupted rise on the Amsterdam market. In terms of "L account" francs, the value of the florin has declined from around 13.15 to 12.86 francs from the end of July through the end of October 1954, which represents a premium for the "L account" franc of about 2.5 per cent in relation to the official franc - florin rate.

3/ In mid-September the City of Antwerp announced the issue of a Fl 12.5 million loan, at 3 3/4 per cent and for a 20 year period, on the Netherlands capital market. Of this amount 6 million was placed privately. A City of Liege loan also was oversubscribed in Holland almost as soon as the lists were open.

4/ One important recent private bond financing has been that of Petrofina, a Belgian petroleum holding company, which announced in September the issue of a Fl 10 million loan, at 4 per cent and for a 15 year period. An additional Fl 10 million will be placed privately. All present and future Belgian taxation on yields from the issue are to be borne by Petrofina. Otherwise issues of Petrofina (the yield of which is subject to a Belgian tax of 18 per cent) would have been at a disadvantage as compared with those of Belgian State or municipal governments (the yield of which is taxable at a rate of only 2 per cent).

For one thing, the Netherlands authorities -- which must clear in advance all domestic or foreign bond flotations so that "order" may be maintained in the market -- may well scrutinize Belgian private issues more carefully than those of the Belgian Treasury or of domestic firms. Moreover, complicated legal problems involved in double taxation of Benelux bond income may also tend to retard the normal flow of investment funds from individual Netherlands investors to Belgian private firms. The Netherlands investor gets partial tax relief on foreign income from certain sources, such as profits from Belgian direct investments or wage-income 1/, but such relief is not, in general, applied to income from Belgian bond or share issues. Thus, it would be tax-wise more profitable for the Netherlands investor to make direct investments in Belgium than to buy Belgian securities, except the public issues which are taxable in Belgium at the low rate of 2 per cent. The Belgian private issues, however, can be made as financially attractive tax-wise as the public issues if the terms of the issues (as in the Petrofina case) provide for tax relief. 2/

Finally, it is uncertain whether there will be a sizeable flow of equity capital and whether, if such a flow develops, it will be from the Netherlands to Belgium, or vice versa. Stock investments are not determined primarily on a basis of current rate differentials, but on a basis of longer-range factors affecting prospective profits levels and industry growth. Important factors include the tax treatment of yields from invested capital and realized capital gains; the anticipated strength of the national markets, influenced by the prospective real national incomes and the marketing structures; and national cost advantages with respect to labor, raw materials sources, transportation, and power supply. In many of these factors the Netherlands presently appears to have some considerable advantage over Belgium. Illustrative of the views of prospective investors is the fact that postwar direct United States investment in the Netherlands has been substantially larger than investment in Belgium although the ratio had been reversed in the interwar period.

1/ The rule is that a Netherlands resident may deduct from his income tax liability an amount equal to the tax which would have been payable on the foreign income if that were his only income. The relief is thus usually less than 100 per cent. Share or bond income qualifies for relief only if such investments constitute part of the corporation's working capital and the income can therefore be treated legally as business profits.

2/ The Belgian investor in Netherlands securities appears to be dealt with taxwise somewhat more favorably than his counterpart, but at current relative bond or share yields a movement of capital from Belgium to the Netherlands would be unattractive. The Belgian national pays an income tax of 18 per cent on income from Belgian private securities, but is taxed at the preferential rate of only 12 per cent on income from foreign securities. As a non-resident, too, he is generally not required to pay the Netherlands income tax on yields from his Netherlands securities. In addition, provision has been made for waiving of the Netherlands dividend tax of 15 per cent (which is normally withheld at the source) in the case of nationals of countries which offer similar treatment to Netherlands nationals (the United States, the United Kingdom, Sweden, and France).

Through the end of November 1954, there had been no large-scale buying by Netherlands investors of Belgian shares, whose present yields are lower than those of Netherlands stocks. 1/ On the other hand, Belgian investors so far have been uninterested in shares of Netherlands companies except in those which are internationally traded.

In view of these difficulties, short-term bank credit, including interest arbitrage by dealers, may tend to move more readily than debenture or equity funds between the Benelux partners.

C. Coordination of Fiscal Policies

Progress in the coordination of the Benelux fiscal systems has, until quite recently, been much slower than that of monetary and capital market policies. Recent Netherlands tax policies appear to be more conscious of the over-all economic and social implications than those of Belgium, chiefly because of continued differences between the two in basic approach to the role of government in controlling economic fluctuations.

Budget policies — The Netherlands Government considers that public revenue and expenditures should be adapted so as to mitigate economic fluctuations, and in general to promote socially desirable purposes, such as the creation of permanent job opportunities and the improvement of housing conditions. Accordingly, in March 1951 the Government acted to curb post-Korean inflationary tendencies by tax increases, accelerated tax collection, subsidy cuts, and economies in civil expenditure. On the other hand, during 1952-53 the budget was used to combat contraction by reducing taxes and by making additional funds available to create employment.

Again, in the 1954 and 1955 budget presentations, recommendations were made for further tax cuts in order to stimulate private investment and distribute the tax burden more equitably; the Netherlands budgetary deficit forecasts (which generally are pessimistic) for 1954 and 1955 are therefore substantially larger than the deficit of 1953.

In contrast, the Belgian Treasury throughout the postwar period has attempted to avoid an "unbalanced" budget on ordinary current account. Irregardless of the current phase of the cycle, there has been an effort, moreover, to limit capital expenditures and the ensuing Treasury deficits on capital account to amounts that could be financed from non-banking sources through private savings or foreign loans. As a result, public investment expenditures, even those necessary for the rehabilitation of the nation's productive capacity, have probably been held below the sum which full utilization of the country's natural and labor resources would have permitted.

1/ Netherlands institutional investors undoubtedly are interested, despite the lower yields, in the risk-spreading offered by the Belgian Colonial and electricity and steel shares, but so far Netherlands buying of such stocks has not yet developed.

Quite recently, the new Belgian Government has been considering the need for greater flexibility in fiscal policies in order to combat unemployment and increase investment. Upon taking office in the spring of 1954, the Prime Minister promised both to stimulate public social and investment expenditures and to reduce taxes. Implementing this policy, a special tax privilege for private investment outlays was enacted in July 1954, whereby about one-third of the amortizable value of new investments will be exempt for two years from the income tax. At the same time, the Finance Minister stated that the new law would be but the first of a series of measures by which the Belgian Government intended to "encourage saving and the spirit of initiative, develop the national industrial plant, stimulate economic activity, and combat unemployment". 1/

Relative tax burdens — Complete financial union would probably imply some attempt at equalizing the tax burden within Benelux, especially that weighing directly upon industrial costs and prices.

Belgium would appear to be better off tax-wise than its partner, as far as the aggregate tax burden relative to national income is concerned. In 1953, total tax revenues of all public authorities represented about 27 per cent of the Netherlands national income but only about 20 per cent of Belgium's national income.

However, certain specific taxes in the Belgian tax structure seem to weigh very heavily upon industrial costs and prices; and, accordingly, to place the Belgian manufacturer at a disadvantage cost-wise as compared with his Netherlands competitor. 2/ Thus, in 1953, the turnover tax accounted for 27 per cent of total Government receipts in Belgium, but only for 19.2 per cent in the Netherlands; stamp and registration, excise, and miscellaneous sales taxes comprise 15.1 and 10.3 per cent of total Belgian and Netherlands revenues, respectively.

1/ The Finance Minister estimated that, if the exemptions provoke new additional productive investment of 10 billion francs ($200 million) it would "produce results which would largely compensate for the fiscal sacrifice" (an estimated 3-4 billion over a 5-year period).

2/ Considerable pressure has accordingly been exerted on the Treasury by Belgian manufacturers for an adjustment of the turnover tax rates; because of the Treasury's revenue needs, these attempts have been largely unsuccessful.

The Belgian Government's reluctance to forego possible revenue yields from the sale of beer, sugar, and spirits has also prevented the full unification of Benelux excise taxes, which had been agreed to under the Benelux Convention of February 1950. This convention provided for application of the same rate of excise on specified lists of commodities throughout the Benelux area; the unified rate for most items was halfway between the minimum and maximum rates then applicable in the three countries. In areas other than sugar and alcoholic beverages, where competitive considerations have been less acute, however, excise taxes in the Benelux countries have in fact largely been unified.

Alignment of direct tax rates is not generally considered to be a prerequisite to economic union. Differences in income tax rates do not appear at present to be important factors in the competition between Belgian and Netherlands industries.

III. Problems of Economic Integration

Economic unions seek to secure a more efficient allocation of resources, and thereby to raise living standards by promoting trade and the specialization of production within the area of the member countries. The reallocation of resources, however, may involve considerable adjustments in the structure of production. Inefficient producers, previously protected, may be forced out by exposure to effective competition; efficient producers, on the other hand, may have to expand their production to meet the needs of a larger marketing area. In such a case, the period of transition is likely to be beset by many difficulties: integration may be opposed by the affected business and labor groups; the necessary mobility of labor may be lacking because of language and other barriers; and the needed mobility of capital may be hampered by institutional barriers.

In the case of Benelux, following the closer alignment of external payments positions and the greater coordination of monetary and fiscal policies, attention has shifted to the issues involved in the structural readjustment of the Benelux economies. These issues include the reallocation of production, the realignment of prices and costs, the easing of the burdens of transition, and the mobility of resources.

A. Problems of Economic Structure

In the formation of an economic union, the greater the complementarity of two previously separated economies, the less will be the need for structural readjustments, and the greater will be the ease of the integration process. Postwar economic development in the Benelux area, however, has been notable for the growth in rivalry between the partner economies. Competition has increased particularly in the consumer goods sector whereas, for the most part, Belgium has retained its superiority in capital goods production. This development was primarily the result of conscious government policies -- particularly by the Netherlands -- undertaken in response to the postwar problems and prospects of the several economies. The productive structures of the partner economies have become more similar and wage and price relationships have been substantially altered. In consequence, the problems of readjustment have been magnified.

The most significant structural change within Benelux since the end of World War II has been the large and rapid industrialization of the Netherlands. This industrialization was deliberately encouraged by the Netherlands Government for several reasons. During the war, a large part of the Netherlands national wealth and productive equipment -- both agricultural and industrial -- was either destroyed or severly damaged. In addition, the richest portion of the country's overseas empire was lost. 1/ Meanwhile, the Netherlands population had increased at a rapid rate and the rise promised to continue; new employment opportunities had therefore to be provided for the additions to the labor force. 2/ Hence the postwar reconstruction task of the Netherlands was not only to restore the wealth destroyed during the war; it also entailed the reorganization of the structure of the economy, and the expansion of its productive facilities, in order to provide increased employment and to achieve viability based on increased exports of goods and services to replace lost overseas investment income.

Virtually full employment of labor and land resources in agriculture offered little hope for expansion in that sector of the economy, either in the form of increased exports or in greater employment. Industry (and especially consumer goods industries), on the other hand, satisfied both criteria. Postwar investment was consequently concentrated in the industrial sector of the economy: from 1948 through 1952, about one-half of net fixed investment was in industry. The monetary, fiscal, and social policies pursued by the Netherlands during this period were designed to encourage industrialization and, in particular, the expansion of the export industries: "easy money" policies together with tax privileges provided a climate favorable to investment; government controls over investment were used to allocate resources to the export industries; while direct controls over wages and prices helped to maintain low unit costs of production.

In Belgium, on the other hand, only a small portion of the national wealth was destroyed during the war; the country's overseas territories remained intact; and population growth was small. Production was swiftly restored and, aided by exceptional demand conditions abroad, a balance of payments surplus was achieved in the early postwar period. Thus neither demographic factors nor balance of payments problems created much pressure for new investment or modernization of existing plant and equipment (except where demand exceeded available capacity at existing prices). The major problem was to maintain financial stability in an otherwise inflationary world; this preoccupation with stability precluded the institution of even cautious expansionary policies when pockets of unemployment appeared in the economy. 3/

1/ Sovereignty over the Netherlands East Indies was formally transferred to the Republic of Indonesia in 1949. However, the Netherlands never fully regained effective control over the area after World War II. The few economic and political ties that had survived the initial separation were severed in August 1954.

2/ Since 1938, the population has increased in the Netherlands by 25 per cent in comparison with about 5 per cent in Belgium.

3/ On this last point, see the unpublished doctoral dissertation of Robert Solomon, Postwar Business Cycles in Belgium, (Harvard 1952) page 215.

The amount of postwar investment in the Netherlands, and the pace at which it took place, was made possible in part by U. S. economic aid. The Netherlands received grants and loans from the U. S. totalling over $1 billion whereas grants and loans to Belgium (excluding "conditional" aid which involved corresponding Belgian exports to other OEEC nations) totalled about $100 million.

Under these circumstances, which resulted in differing national policies, the proportion of resources devoted to industrial investment was greater in the Netherlands than in Belgium; industrial expansion accordingly proceeded at a more rapid rate in the former country. In 1953, industrial production was 62 per cent above the 1938 level in the Netherlands, as compared with 39 per cent in Belgium. In the Netherlands, moreover, industry (including construction) now contributes 44 per cent of the national income in comparison with 30 per cent before World War II. 1/

B. Wage and Price Relationships

The increasing competitiveness arising out of the greater similarity in the structures of the several Benelux economies has been accentuated by the change in wage-price relationships within the area. Before World War II, wages and prices were appreciably higher, perhaps by as much as 35 per cent, in the Netherlands than in Belgium. In contrast, an estimate for 1951 placed money wages (including social security premia) in Belgium 40 to 60 per cent higher than in the Netherlands. A crude estimate of labor costs — that is, allowing for differences in labor productivity — revealed for the same year a 25 per cent differential. 2/

1/ Unfortunately, the lack of Belgian national income statistics by industrial origin prevents an adequate comparison of the structures of production (and the changes therein) of the Benelux economies during the postwar period. Nevertheless, the Netherlands figures by themselves seem to indicate that the economies are now more similar than prior to the Second World War since the Belgian economy has undoubtedly remained predominantly industrial.

2/ With the exception of the estimate of differences in labor costs which was made by Professor van den Brink, the estimates in this paragraph are those of Professor Brouwers quoted in J. R. M. van den Brink, "Benelux", Amsterdamsche Bank Quarterly Review, No. 100, 1953. These differences have been somewhat reduced by the recent wage increase in the Netherlands, but the disparity remains substantial.

The change in wage relationships in the Benelux area took place largely in 1945 and 1946. From 1946 through 1954, hourly money wage rates increased by about the same percentages in Belgium and in the Netherlands; wages were linked to the cost-of-living in Belgium and set by the Government in the Netherlands. The devaluation of the guilder in 1949 by 25 per cent in respect to the Belgian franc, however, immediately widened the then existing disparity in wage levels by a similar percentage.

The competitive advantage afforded Netherlands producers by low wages has caused complaints by Belgian firms of the loss of domestic markets to Netherlands competition. 1/ Until recently, the Belgian Government accordingly made repeated representations for an increase in Netherlands wages; in particular, it was critical of continued government controls over wages in the Netherlands. The Netherlands Government rejected the Belgian requests maintaining that wage controls were necessary to protect the Netherlands balance of payments position. In 1951, the Netherlands Government, in agreement with the trade unions, even employed a deliberate cut in real wages to curb consumption and thus to rectify the imbalance in the country's external payments; wage controls have been maintained since that time to protect the newly achieved balance of payments surpluses. 2/

On January 1, 1954, however, a five per cent wage increase was decreed in the Netherlands. Although primarily designed to offset a rise in rents and to restore the real wage cuts of 1951, the wage increase (or at least its timing) may have been influenced by Benelux considerations. Significantly, too, an attempt was made to allow free wage formation; this proved a failure, however, as labor and management were unable to agree on terms and the Government had again to intervene. Another wage increase of 6 per cent went into effect on October 1, 1954. These wage increases notwithstanding, the disparity in wages between the Netherlands and Belgium probably still exceeds the 20 per cent differential often stated by the Belgians as the maximum compatible with "fair" competitive conditions within Benelux.

1/ In 1952-53, these complaints were partly inspired by depressed business conditions in Belgium which drew attention to Netherlands competition.

2/ The Social and Economic Council stated in 1953 that "even in the case of wage formation as this would be required by the free-market economic theory, no level of wages differing substantially from that now existing would be expected." Paradoxically, the Council went on to recommend continued government control over wages. Quoted in van den Brink, op.cit., page 52.

The wage-price problem relates basically less to money wage levels than to the level of "efficiency wages" affecting production costs. The problem of production costs, in turn, is connected with the volume of postwar investment. Larger investment in marginal Belgian industries and firms might have increased their productivity to the extent necessary for them to compete effectively with Netherlands products even at present money wage levels. As mentioned before, however, the Netherlands has devoted more of its resources to productive investment than has Belgium throughout the postwar period.

C. Transitional Arrangements

The process of integration of the Benelux economies began in 1950 with the removal of most quantitative restrictions on intra-Benelux trade. Since this date coincided fairly closely with the termination of post-Korean inflationary pressures, the economies of the partner countries had to undergo the adjustments involved in the disappearance of abnormal demand conditions abroad as well as the adjustments incumbent in the Benelux integration process. Benelux conferences in recent years have been concerned primarily with easing the burdens of this transition.

Agriculture — Agricultural production in the Benelux countries has been protected from the competition of the partner countries since the institution of Benelux. The Agricultural Protocol of 1947 permitted each country to guarantee minimum prices to agricultural producers that would assure an adequate margin of profit and to impose quotas on all foreign produce for this purpose. 1/ This system was revised by the Agricultural Protocols of 1950 which established a Benelux commission charged with establishing by mutual consent minimum prices in each of the Benelux countries; price equalization duties were to be levied on products traded within the area and the proceeds from these duties were to be divided equally between the partners. Only when the commission failed to agree on minimum prices, was a country empowered to impose unilaterally import quotas against a partner country's produce.

The Netherlands has a competitive advantage in many agricultural commodities by reason of its natural factor endowment aided by extremely low rents, low wages, and government subsidies; in addition, it is served by more efficient agricultural marketing organizations. Accordingly, most agricultural products shipped from the Netherlands to Belgium have been taxed in order to equalize their prices with the prices established in the Belgian market.

1/ In this Protocol, many commentators saw the failure of Benelux. It should be remembered, however, that agricultural producers in Luxembourg have been protected from Belgian competition ever since the institution in 1921 of the otherwise comprehensive Belgium-Luxembourg Economic Union.

The Netherlands has become increasingly restive concerning the Agricultural Protocols and has recently sought modifications. It particularly objects to the sometimes sudden imposition of quotas on Netherlands produce; such a move occurred in the spring of 1954 when Netherlands' tomatoes and lettuce were suddenly banned from the Belgian market. Actually, the problem of instituting effective competition in the agricultural sector within Benelux is probably intractable because of domestic political considerations in both partner countries.

Industry -- The solution of problems of industrial integration has been sought on two levels: on the government side, temporary protective measures have been taken for restricting intra-Benelux trade in certain commodities either by special excise or "equalization" duties or by quantitative restrictions; in the business sphere, inter-industry agreements have been encouraged which limit or ease competitive conditions in certain branches.

In October 1952, the Benelux minister established special committees to investigate competitive conditions in the tobacco, leather, paper, furniture, paint, and heating supplies industries. These committees, which included representatives of the affected industries in addition to government officials, were to encourage arrangements by the industries themselves, when necessary, to ease the transitional burdens. Several inter-industry agreements resulted from the work of these committees, usually taking the form of minimum-price agreements. Where the committees were unable to effect such agreements, as in the case of the cigar and wooden furniture industries, the Netherlands Government consented to temporary quotas on Netherlands exports of these products to Belgium. In a few cases the committees found that the difficulties of Belgian enterprises arose from competitive conditions in general rather than from the competition of Netherlands firms alone; in this way, the committees probably eased some of the tension over the question of "unfair" Netherlands competition which has beset Benelux.

Further efforts to provide some protection for Belgian industry in the transitional period culminated in the protocol of July 24, 1953, "Concerning the Coordination of Economic and Social Policies". By means of an elaborate formula, this protocol established conditions under which one partner could seek temporary protective measures against the other. Under this formula, it has to be proved that production in one country has suffered a considerable decline as a result of imports from one of the other Benelux countries (and not from outside the Union). 1/ The

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1/ The formula provides that exceptional measures may be taken only if: (a) production has declined by 15 per cent or more in a given sector compared with the average of corresponding semesters for the two preceding years, and that this decline is more than 75 per cent attributable to increased imports from a partner country; or, (b) that the volume of imports in a given sector has increased by 60 per cent, or an amount equal to 15 per cent of production, compared with the average of corresponding semesters for the two preceding years provided that --

1. production has not increased in the importing country,
2. not more than 20 per cent of the increase in imports is attributable to imports from third countries,
3. imports from partner countries have not substituted for imports from third countries, (contd. on next page)

protocol also provided arbitration provisions in the event of disagreements among the partners as to the necessity of protective measures. The need for the continuation of measures, if taken, is to be reviewed by the partners every six months. 1/

In the same protocol, the Benelux countries agreed, in principle, to the establishment of a "readaptation fund". The fund would assist industries affected by integration in rationalizing their production to accord with competitive conditions or in shifting into different lines of production. As yet, however, the Benelux Governments have been unable to agree on the composition and operation of the fund.

It was recognized by all parties that the provisions of the protocol were not completely in accord with the professed objectives of the economic union. However, it was also recognized that some measures were necessary to ease the tension within Benelux arising from the wage-price issue which, if unrelieved, might have compromised the entire project. In this respect, the protocol was successful. 2/

D. Mobility of Resources

The problem of attaining sufficient mobility of factor resources within Benelux has not been completely solved. While the question of the mobility of capital has been attacked — though not necessarily with permanent success — by the creation of a common capital market, restraints still exist on the movement of labor.

In general, the movement of labor required in an economic union would have both intra- and inter-national aspects. Within each partner country, labor would move between firms and industries as certain firms and industries declined and as others expanded as the result of competition within the union. Among the countries forming the union, labor would move as the loci of production were shifted from one country to another.

(Footnote 1, page 19, cont'd.):
4. imports from partner countries constitute at least 7 per cent of the consumption of the importing country.

1/ It is said that between 10 and 15 per cent of all industrial exports from the Netherlands to Belgium were affected by measures taken under this protocol. See International Financial News Survey, January 8, 1954.

2/ The Netherlands wage increases of January and October 1954, referred to above, also did much to relieve intra-Benelux tension. Most recently, the improvement in Belgium economic conditions has distracted attention somewhat from Netherlands competition.

In addition to the normal barriers of language and tradition, there are at present legal restraints to the actual movement of labor within Benelux. But even given perfect mobility of labor, there is some doubt whether labor would in fact move. At first glance, it might be expected that Netherlands nationals would tend to move to Belgium in response to higher real wages. 1/ A movement of labor resources in this direction would presumably not only improve the allocation of resources, and tend to equalize wage levels; it also would relieve demographic pressures in the Netherlands and add stimulus to the Belgian economy. Such a movement, however, would require that employment opportunities exist in Belgium; a regular movement over a longer period, moreover, would require that these opportunities be continually expanded. Actually, Belgium has at present a high rate of unemployment whereas the Netherlands enjoys virtually full employment. Were it not for the differences in real wage levels, therefore, employment opportunities would warrant a movement of labor from Belgium to the Netherlands.

There has been some consideration by the Benelux countries of reducing the legal barriers to the free movement of labor within the union. As yet, these efforts have been unfruitful. Part of the reluctance to freeing labor movements might be explained on political and social grounds. Any movement of labor into Belgium from the Netherlands would upset the rather tenuous political balance between the Flemish and Walloon segments of the Belgian population; similarly, any movement from Belgium into the Netherlands would upset the equally tenuous balance between Protestant and Catholic elements in the Netherlands. Moreover, Belgian labor would probably oppose any significant importation of labor from the Netherlands because of the prevailing volume of unemployment; conversely, any inflow of labor to the Netherlands from Belgium would probably be opposed by Netherlands labor groups on the grounds that it would retard the upward movement of wages.

Assessment

The Benelux countries have obviously not yet reached their goal of full economic union. The question is, however, whether or not they have made satisfactory progress toward that goal. As compared with the original expectations, progress has been disappointingly slow. Those expectations, however, were overly sanguine: they were politically inspired and based on false assumptions as to postwar economic conditions. Taking into consideration the magnitude of the problems involved, progress has been significant: tariffs and most quantitative restrictions on trade between the partners have been abolished; a unified tariff system has been established vis-a-vis the rest of the world; a

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1/ Differences in social security premia and benefits need not be taken into account as a reciprocal social security agreement exists between the partner countries; moveover, the Benelux countries are currently seeking to coordinate further their social security systems.

common capital market has been instituted; many excise taxes have been unified; and the coordination of Benelux foreign economic policies has begun. Perhaps even more important, progress toward economic union, with some exceptions, has been steady and, in recent years, accelerated.

Nevertheless the prospects for the ultimate integration of the Benelux economies are uncertain. Mobility of labor is lacking, and there is no assurance that any flow of capital will accord with the needs of integration and of balanced development within Benelux. Moreover, the present transitional arrangements hampering competition between Belgian and Netherlands agriculture and industry might easily become self-perpetuating and prove impossible to abolish at a later date. On the other hand, the alternative solution -- allowing readjustments through the free play of market forces -- might destroy the entire project.

It may also be doubted that Benelux economic and financial policies can be much further coordinated because of the divergent basic problems of the separate economies. In the Netherlands, economic policies will continue to be based on the need for expansion of industry and exports; expansionary fiscal measvres and "easy money" policies are likely to be combined for this purpose with restraints on wages. 1/ In Belgium, on the other hand, the primary concern will probably continue to be stability. It is questionable whether the separate interests of the partner countries would be subordinated to the common interest in conflicts arising from these approaches. 2/

1/ For a full statement of this view, see the Netherlands Export Policy, Memorandum to the States-General, March 31, 1952.

2/ This possibility is clearly indicated by a recent case. The Netherlands Government proposed to finance a soda ash factory in the Netherlands. The Belgian Government objected on the grounds that existing plant and production in Belgium was sufficient to meet needs of the entire Benelux area. Notwithstanding the Belgian objection, the Netherlands Parliament recently approved the project. At the time, the Netherlands Government stated that state financing was necessary if the industry was to have a fair chance against Belgian competition.

Fundamentally, the degree to which the Benelux economies are ultimately integrated will depend upon the willingness of the respective governments and peoples to effect a union. Despite many disappointments, the responsible authorities of the Benelux countries have persisted in their efforts to bring about the union. Recent public opinion polls in Benelux suggest, however, a great deal of apathy on the part of the population toward Benelux; without popular support, it is difficult to imagine continued effort on the part of the Governments.

Another measure of the "success" or "failure" of Benelux would be the gain in welfare for the partner countries and for the area as a whole. According to Professor Viner, the welfare gain of a customs union will be the greater (1) "the greater the degree of rivalry with respect to protected industries prior to customs union," and (2) "the greater the differences in unit-costs for protected industries of the same kind." 1/ These conditions certainly obtain in Benelux; in fact, they account for the present difficulties of integration. From this point of view, the Benelux union should therefore bring a gain in welfare.

A gain in welfare is also achieved in an economic union if the expansion of trade between the partners, following the removal of tariff barriers, does not mean a corresponding reduction in trade with third areas. However, there is at least one indication that intra-Benelux trade so far may have increased largely at the expense of the rest of the world. 2/ The new Benelux tariff is higher than the old Netherlands tariff and probably not less high than the old Belgian tariff; the new tariff would thus appear higher than the average of the two old tariffs. 3/ This rise in tariff protection, by itself, would imply a loss of welfare to the area as a whole and to the Netherlands, and little (if any) gain to Belgium.

In addition, an economic union may increase the welfare of an area through improving its terms of trade: increasing the size of a trading and producing area may improve that area's bargaining power vis-a-vis the rest of the world. The Benelux area may have benefitted from this phenomenon but it would hardly be possible to measure such a gain.

1/ J. Viner, The Customs Union Issue (New York 1950), pp. 41-55. Other conditions listed by Viner are too technical to be evaluated here. They include the relation of the customs union's tariffs to the height of tariff levels in potential export markets, and certain aspects of economies of scale.

2/ The statistical evidence on this point is inconclusive: as compared with pre-war, intra-Benelux trade has expanded to a greater extent than Benelux trade with the rest of the world; however, since 1950 when intra-Benelux trade was for the most part liberalized, trade between the partners has risen at about the same rate as their trade with the rest of the world.

3/ On this point see W. Buchdahl, "The New 'Benelux' Union—Western Europe Tariff Pattern?", Foreign Commerce Weekly, October 11, 1947.

It is difficult to estimate how the gains from union (if any) have been (or will be) distributed among the partner countries. In the early years, the advantages of Benelux were probably mutual: Belgian aid was instrumental in the Netherlands reconstruction program while the freeing of intra-Benelux trade in 1950 helped to relieve a recession in the Belgian textile industry. In recent years, however, the burden of adjustments involved in the union appears to have fallen mainly on Belgian industry.

It is even more difficult to evaluate the effect of Benelux on the rest of the world. An improvement in the terms of trade of Benelux obviously means a corresponding deterioration in the terms of trade of the rest of the world. Apart from this factor, however, an improvement in the real income of Benelux might also benefit its trading partners (but only to the extent that intra-Benelux trade did not displace trade with the rest of the world). The very great importance of foreign trade in the Benelux economies would tend to magnify such effects.

Perhaps the most important value of the Benelux experiment is its significance as a case study in the problems of economic integration. Projects for European (or North Atlantic) economic integration must take cognizance of the difficulties encountered in Benelux. Even if the prospects of wider integration prove disheartening, the experience may direct attention to other and perhaps more promising methods of achieving international economic cooperation.