

ESSAYS IN INTERNATIONAL FINANCE

No. 25, March 1956

THE BELGIUM-LUXEMBOURG
ECONOMIC UNION,
1921-1939

Lessons from an Early Experiment

JAMES E. MEADE



INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS AND SOCIOLOGY

PRINCETON UNIVERSITY

Princeton, New Jersey

This is the twenty-fifth number in the series ESSAYS IN INTERNATIONAL FINANCE *published from time to time by the International Finance Section of the Department of Economics and Sociology in Princeton University.*

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GARDNER PATTERSON, *Director*
International Finance Section

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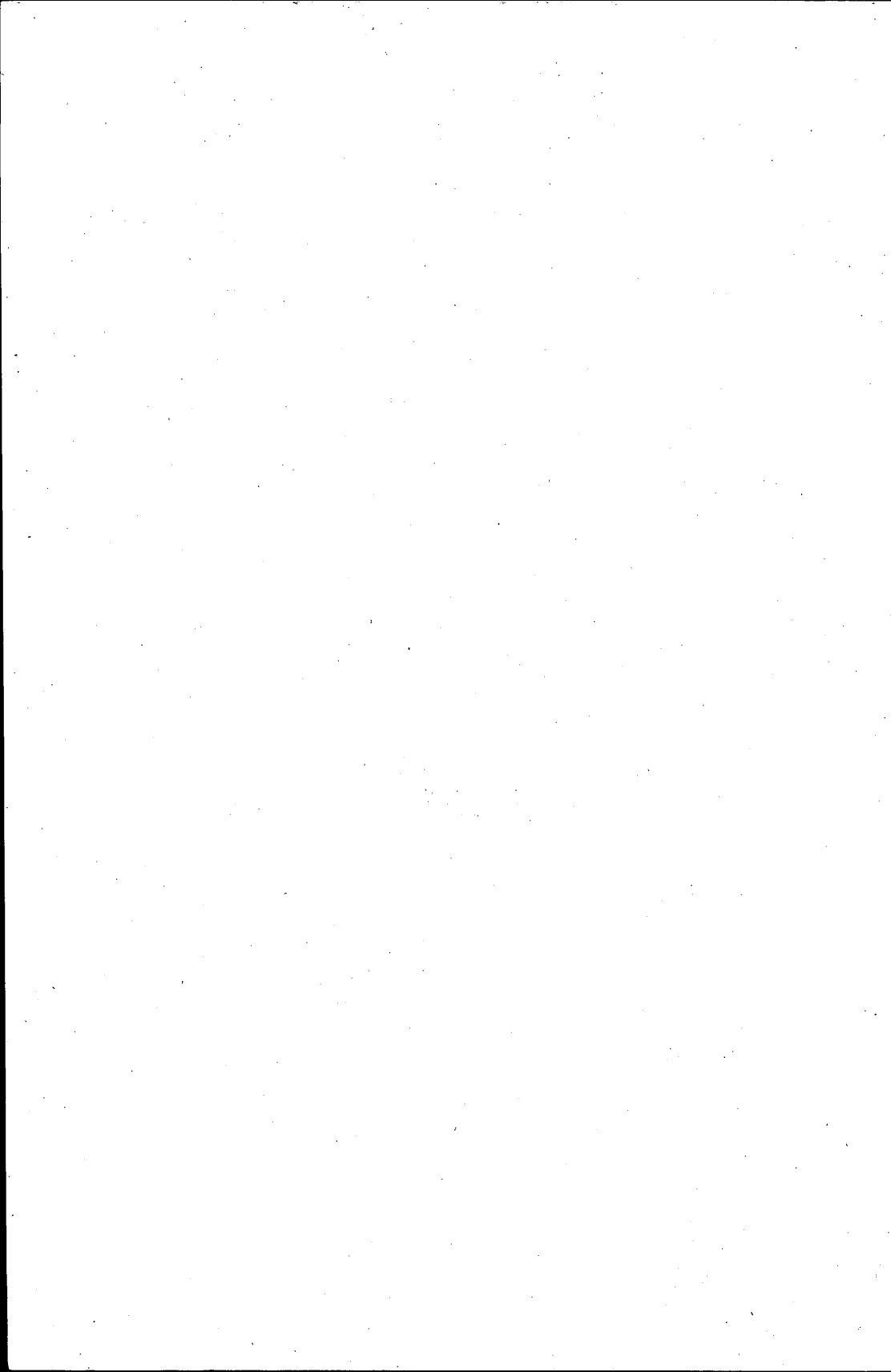


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THE BELGIUM-LUXEMBOURG ECONOMIC UNION, 1921-1939*

LESSONS FROM AN EARLY EXPERIMENT

I. INTRODUCTION

THIS essay does not purport to be a history of the Belgium-Luxembourg Economic Union in the inter-war period. It is merely a brief description of the economic principles and the machinery of operation of that Union. The Belgium-Luxembourg Economic Union constitutes practically the only example of a successful economic union of any importance in that period. It is thought, therefore, that a short description of its provisions and mode of working may be of interest at the present time when so many people in so many parts of the world are busy constructing economic unions, or schemes for greater economic integration, of one kind or another.

Before the first world war Luxembourg had been part of the German Zollverein. As a result of the war the link with Germany was broken. It was clear that Luxembourg must be linked economically either with France or with Belgium. As a result of diplomatic negotiations after the war it became clear that the link must be with Belgium.†

The text of the treaty establishing the Belgium-Luxembourg Economic Union was signed on the 25th July 1921; ratifications were exchanged on the 6th March 1922; and the treaty entered into force on the 1st May 1922.

II. THE BASIC PROVISIONS OF THE TREATY OF ECONOMIC UNION

The basic provisions of this treaty were those of a full customs union, subject to a number of special exceptions which will be discussed be-

* The author would like to express his gratitude to the many Belgian and Luxembourg officials who have helped him with information in the preparation of this essay. It is introductory to a study which the author is preparing for the Royal Institute of International Affairs, with the help of the Economic Research Division of the London School of Economics, on the building of the Benelux Economic Union.

† For an account of these negotiations, see Émile Majerus, *Das Wirtschaftsbindnis des Grossherzogtums Luxemburg mit Belgien*, Luxembourg, 1928, pp. 9-26; Luc Hommel, *Une Expérience d'Union Économique. Bilan de dix années d'union économique Belgo-Luxembourgeoise*, Louvain, 1933, pp. 31-40; and J. Treinen, *L'Économie Lux-*

low. A common customs tariff was instituted for goods entering into the Union. Customs duties on goods moving between the two countries were abolished. For most products excise duties levied within each country were unified so that goods could pass from one country to the other without the need for the levying of excise duties at the common frontier for the purpose of offsetting differences in rates of excise duty in the two countries. The revenue from customs duties and the common excise duties was paid into a common fund from which the cost of administration of the duties was deducted. The remaining net revenue was distributed between the two national governments in proportion to the populations of the two countries. At the time of the formation of the Union Belgium had a population of some 7,500,000 and Luxembourg a population of some 275,000, so that $1/29$ of the net revenue accrued to Luxembourg.

In addition to these arrangements for customs and excise duties there were other provisions in the treaty to make the economic union an effective one. There were (subject once more to the exceptions which will be discussed below) to be no quantitative restrictions or other taxes or charges on the movement of goods between the two countries. The citizens of each country were in all relevant economic matters to be subject in the other country to treatment as favorable as that given to the nationals of that other country. In particular the public authorities in each country were to grant equal treatment in granting public contracts to the nationals of both countries.

The treaty was, therefore, essentially one which attempted to set up a common market for goods and services throughout the Belgian-Luxembourg area in which trade could be carried out freely and on fair and equal competitive conditions. It did not contain any provisions attempting to ensure a common market for the ultimate factors of production throughout the area; that is to say, it did not attempt to ensure the free movement of labor and capital between the two countries on fair and equal competitive conditions.

At the time of the inception of the Belgium-Luxembourg Economic Union quantitative import restrictions were not of great importance. The trade of the Union with the outside world was in the main regulated by customs duties; and the treaty of 1921 was silent on the subject of quantitative controls over the trade of the Belgium-Luxembourg Economic Union with the outside world. In the 1930's, however, the picture changed. As the great depression developed the countries of Europe

embourgeoise sous le Régime de l'Union Douanière Belgo-Luxembourgeoise, Luxembourg, 1934, pp. 16-25.

made greater and greater use of quantitative import restrictions as a means of keeping their balances of payments in equilibrium and of protecting their domestic industries against foreign competition. Belgium and Luxembourg were no exceptions to this rule. On 23rd May 1935, a supplementary convention was signed between the two countries which applied to quantitative trade restrictions the same principles which had been applied to the common customs tariff in the main treaty of 1921. That is to say, subject to some exceptions which will be discussed below, all quantitative regulations were to be imposed as a single scheme covering imports into the Union as a whole, and not as two separate schemes covering imports into each partner separately. This would allow the products concerned to continue to move freely within the Union. The yield of any revenue from any special licence fees on the imports of products subject to joint import controls was to be paid into the common pool of customs and excise revenue set up under the main treaty of 1921.

III. THE ADMINISTRATIVE MACHINERY OF THE UNION

Under the treaty two joint Councils were instituted to ensure the proper working of the Union. First, a *Conseil administratif mixte* was set up, composed of two Belgian and one Luxembourg official, whose function it was to administer the joint pool of revenue from the customs and common excise duties, to supervise the administrative costs to be set against this revenue, to distribute the remaining net revenue between the two governments in proportion to the populations of the two countries, and in general to advise the two governments on matters connected with the administration of the joint system of customs and excise duties.

Second, a *Conseil supérieur de l'Union* was instituted with three Belgian and two Luxembourg members. This body was to deliberate and advise on the broader policy issues involved in the formation, development, and smooth working of the Union. It was composed not of administrative officials but of ministers, members of parliament, professors, businessmen, and so on. Its members received briefs from their governments but the Council could reach independent decisions opposed to the governments' views. It had its seat in Brussels and was provided with a Secretariat, a Belgian Secretary General and a Luxembourg Assistant Secretary General. It was to meet at least once a month. Its opinion had to be sought on all proposals to change existing rates of customs and excise duties or to change commercial policy in other important respects (e.g. through the imposition of import restriction). It could itself take the initiative in making proposals on these issues. In carrying out these duties it could receive briefs from governments and take evidence

from officials, experts, and interested parties. Under the treaty of economic union it was also given the more general duty of considering the assimilation of the two national systems of social, financial, and economic institutions and policies.

There was also provision in the treaty (superseded in 1927 by a more general treaty of Conciliation, Arbitration, and Judicial Settlement between the two countries) for the institution of an *ad hoc* arbitral tribunal to be set up in case of a dispute between the two governments about the carrying out of the provisions of the treaty.

Reference has already been made to the fact that in 1935 a protocol was signed between the two governments to set up a regime for a single common programme of imports into the Union for those goods which were now subject to quantitative import restrictions. The Belgian government retained the ultimate right to decide upon and to impose the restrictions; but a *Commission administrative mixte Belgo-Luxembourgeoise* (generally known as CAMBL) composed of officials of both countries, was set up to advise on such restrictions as either government might suggest and the measures which the Belgian government decided to adopt for the Union as a whole had to be submitted for the prior opinion of this joint committee. It was also one of the duties of the joint committee to divide out the licences among the interested parties. If the Luxembourg government felt that the Belgian government had not safeguarded Luxembourg's vital interests in the operation of the import programme for the Union, it was empowered to appeal to an arbitral body on this issue.

The severity of the quantitative restrictions needed to be frequently varied to fit in with changes in the world markets outside the Belgium-Luxembourg Economic Union; the choice of products for restriction clearly would vitally affect the other economic policies and programmes of the two governments; and the distribution of import licences between the claimants in the two countries would raise an important problem of conflicting national interests. The problems which confronted this new joint official committee were for this reason much more difficult than those which confronted the similar joint official committee set up under the treaty of 1921 to supervise the operation of a more or less fixed and predetermined tariff of import duties.*

The subsequent history of these four administrative organs is of some

* In the period under consideration neither country imposed any foreign-exchange control. But since the end of the second world war there has been a joint official body, the *Institut Belgo-Luxembourgeois du Change*, to arrange for the operation of a joint and common system of exchange control for the two countries. This joint body has worked efficiently and smoothly.

interest to the student of economic unions. The *Conseil administratif mixte* has successfully carried out its limited technical task of dealing with supervision of the common tariff. The *Conseil supérieur de l'Union* had some limited influence in the first decade of the Union in resisting protectionist pressures in the two countries. But it never achieved any notable success in assimilating the two national systems of social, financial, and economic institutions and policies; for example, in spite of its efforts to do so, it failed to achieve any assimilation of the Belgian and Luxembourg turnover taxes. It has subsequently faded into more or less complete insignificance. The machinery for the arbitration of disputes between the two governments arising out of the treaty of 1921 has only been used once, namely, in connection with a dispute about the provisions of the treaty which dealt with the iron and steel industries (see Section XI below); and even in this case the procedure was, as will be seen below, notoriously unsuccessful. On the other hand, the *Commission administrative mixte* with its extremely difficult task of administering, and of making frequent adaptations in, a joint programme of import quotas for two sovereign independent States has been an almost equally notable success. Finally, the practice has become more and more clearly established whereby any major difficulties in the application of the treaty of economic union have been the subject of direct negotiations between the relevant ministers of the two countries; it is in this way, for example, that the problem of the steel industry to which reference has just been made was in fact finally solved, and it was by this method that in 1935 the many modifications which, as we shall see, the changed circumstances of the 1930's made necessary were in fact brought into effect.

In brief, in the treaty of 1921 there is some trace of the idea that the organs of the Union might prove to be something independent of, perhaps even superior to, the two national governments concerned. Thus while the *Conseil supérieur de l'Union* was a purely advisory body, it was composed of "wise men," largely independent of the two national governments, whose opinions were clearly intended to have a great influence upon future policies; and the arbitral procedure was clearly intended to provide an independent semi-judicial decision about the interpretation of the obligations of the treaty which might override the contentions of either or both of the national governments concerned. In fact this part of the administrative apparatus has not worked. The Union has operated successfully as a working arrangement between two sovereign governments which have come to trust each other and to share a common desire to make the Union work. The treaty of 1921 and its subsequent protocols have imposed fairly precise and detailed

obligations on the two governments. But disputes about, and modifications of, these obligations and mutual adjustments of incompatible national policies have been successfully achieved through a continual process of consultation and negotiation both at the official and at the ministerial level in the two governments.

IV. BELGIUM AS THE PREDOMINANT PARTNER

The Belgium-Luxembourg Economic Union was a union between a relatively large and a relatively small partner. As has already been pointed out, at the time of the formation of the Union the population of Belgium was some 7,500,000 while the population of Luxembourg was no more than 275,000. Only in their steel industries, where in the inter-war period the outputs of the two countries were roughly of the same order of magnitude, were the economies of the two partners in any respect of comparable magnitude. In every other respect the Belgian economy was incomparably larger.

The natural result of this simple difference in size has been that within the Belgium-Luxembourg Economic Union, Belgium is without question the predominant partner. We have already seen the effect of this fact in the institutions of the Union. Both in the *Conseil administratif mixte* and in the *Conseil supérieur de l'Union* Belgium has the majority of members and the majority of votes, and the seat of the secretariat of the Union is in Brussels. But the predominance of Belgium went much further than this. The common tariff of customs duties for the Union was, under the treaty of 1921, instituted through the adoption by Luxembourg of the existing Belgian tariff; and the unification of the excise duties, which took place for most products other than alcohol, was based upon the adoption by Luxembourg of the rates of excise duty ruling in Belgium. Belgium obtained the right to modify these rates of duty on behalf of the whole Union and to negotiate commercial treaties with third countries in the name of the whole Union. The interests of Luxembourg were recognized in the obligation of Belgium under the treaty not to modify existing rates of duty without taking the advice of the *Conseil supérieur de l'Union* on which the Luxembourg representatives could, of course, express the interests of their country. Belgium also undertook at the request of the Luxembourg government to take measures to get the benefits accorded under existing commercial agreements by third countries to Belgian trade extended to cover Luxembourg trade as well, and not to modify existing commercial agreements or to conclude new ones except after consultation with the Luxembourg government.

Similarly, as we have already seen, under the arrangements made in 1935 for a common regime of quantitative import restrictions into the Belgium-Luxembourg Economic Union, Belgium retained the ultimate right to decide upon the import quotas which were to be imposed, after consultation and negotiation with Luxembourg through the *Commission administrative mixte*.

The fact that one of the two partners was of predominant size greatly simplified, at least in form, some of the arrangements for economic union. Thus no technical problem arose in the formulation of the common tariff of customs and excise duties; the rates of the predominant partner were adopted by the other partner. Moreover, the predominant partner retained the ultimate right of deciding upon future changes in rates of duty and in import restrictions and thus of affecting not only the commercial policy but also, through the common pool of customs and excise duties, the budgetary revenue of the other partner. The predominant partner had at every stage to consult and to take into consideration the interests of the other partner; and in fact, as in the negotiations for a commercial agreement between Belgium and France in 1923, the Belgian government has included representatives of the Luxembourg government in its delegation, whenever Luxembourg interests have been especially concerned, although it was not under any treaty obligation to do so.

It would be false to conclude from these legal provisions of the treaty that in fact the interests of Luxembourg have tended to be subordinated to those of Belgium. On the contrary, on some occasions "the importance of being unimportant" has brought advantages to Luxembourg interests. For example, an act of policy which enabled Luxembourg agriculture to gain at the expense of Belgian agriculture might well represent a very appreciable gain per head for the small number of Luxembourg farmers at the expense of an almost insignificant loss per head for the much larger number of Belgian farmers. There is very general agreement that whatever the treaty provisions may be, Luxembourg commercial interests have in fact received at least their proper weight in the joint commercial-policy arrangements of the Belgium-Luxembourg Economic Union.

V. EXCEPTIONS TO THE PRINCIPLE OF A COMMON COMMERCIAL POLICY FOR THE BELGIUM-LUXEMBOURG ECONOMIC UNION

A complete economic union requires that there should be a single commercial policy for the union as a whole *vis-à-vis* the outside world.

For example, there would be little point in Belgium putting a barrier against the import of coal from Germany, if German coal could be freely imported into Luxembourg and could then be freely moved over the Luxembourg-Belgian border.

The treaty of 1921 provided for a more or less complete application of this principle in so far as barriers to imports in the 1920's were concerned. In those years such barriers to imports took almost entirely the form of import duties and, as we have already seen, the treaty provided that Luxembourg should apply the Belgian import tariff.

As we have also seen, Belgium undertook under the treaty of 1921 to take measures to persuade other countries to accord to Luxembourg exports the same benefits as they had promised to accord to Belgian exports under existing Belgian commercial agreements, and in future to conclude new commercial agreements on behalf of the whole Belgium-Luxembourg Economic Union after consultation with the Luxembourg government. This principle of equal treatment in third markets for Belgian and Luxembourg products was in fact very generally applied; but there were a few exceptions.

First, there was no immediate or complete success in getting the benefits of existing Belgian commercial treaties extended to Luxembourg products. Thus for some years Luxembourg steel fared badly in the Spanish market because Spain imposed her maximum tariff against Luxembourg steel and her minimum tariff against competing German, French, and Belgian steels.

Second, before the first world war Luxembourg, as a member of the German Zollverein, had sold a large part of some of her products in Germany. There was accordingly included in the Treaty of Versailles an obligation on Germany's part to admit certain amounts of certain Luxembourg products (e.g. wine and steel) free of duty into Germany for a period of five years in order to enable Luxembourg to make a more gradual adjustment of the structure of her exports. This privilege in the German market did not extend to similar Belgian products, and was therefore an exception to the general principle of equal treatment for Belgian and Luxembourg exports in third markets.

Third, a somewhat similar phenomenon arose as a result of the commercial *modus vivendi* reached between France and the Belgium-Luxembourg Economic Union in 1924. Some of Luxembourg's principal export markets had before the first world war been in Alsace-Lorraine which, with Luxembourg, had formed part of the German Zollverein. Alsace-Lorraine was now part of France. In the agreement of 1924 it was accordingly arranged that for a period of two years there should

be special tax-free quotas on imports into France of milk and of tanning-bark over the Luxembourg frontier, so as to give some temporary security to these old-established Luxembourg export markets. These privileges did not extend to exports into France over the Belgian frontier.

But all these instances are of very secondary importance. The principle of a single common commercial policy for the Union as a whole *vis-à-vis* third countries can be regarded as of practically universal application until the use of quantitative restrictions over imports and exports became widely used in the 1930's. As we have seen, the treaty of 1921 said nothing about the use of quantitative restriction over imports into the Belgium-Luxembourg Economic Union. In the 1930's both countries began to impose such restrictions. In many cases these import restrictions were from the outset imposed as a single joint programme of import into the Union as a whole. But that was merely because the Luxembourg government agreed in each particular case to join in the Belgian scheme. In some cases separate and divergent schemes of quantitative restriction were imposed.

The position was regularised by the convention of 23rd May 1935 which in general extended the principle of a joint commercial policy to quantitative restrictions over imports and exports. But, as we shall see, there were a number of exceptions, notably in the fields of agricultural products and of imports of coal and coke. In these cases the two partner countries restricted imports from third countries with different degrees of severity; and in consequence they had also to impose restrictions on trade over the common Belgium-Luxembourg frontier in order to prevent supplies from third countries entering the country with the severe import restrictions *via* the country with the more liberal import policy.

VI. THE ABSENCE OF BALANCE-OF-PAYMENTS RESTRICTIONS WITHIN THE BELGIUM-LUXEMBOURG ECONOMIC UNION

In many modern forms of partial or complete economic union (for example, the Benelux economic union after the second world war) a major difficulty in applying the principle of free-trade within the union has been the need to maintain, on balance-of-payments grounds, restrictions on trade and on payments between one partner country and another. This difficulty was completely absent from the Belgium-Luxembourg Economic Union in the inter-war period—(and indeed has remained completely absent since the second world war as well). This

was so because of the monetary arrangements within the Union which resulted in the fact that there was never any technical problem of financing payments between the two partner countries.

Since the inception of the Belgium-Luxembourg Economic Union, there has been a limited and subsidiary circulation of a local currency, namely of Luxembourg francs, in Luxembourg. But the Belgian franc has in fact been the main currency in circulation in Luxembourg as well as in Belgium. For this reason, anyone in Belgium who has had a payment to make in Luxembourg or anyone in Luxembourg who has had a payment to make in Belgium has in fact been able to do so by the simple transfer of Belgian francs from the one country to the other. The other side to this picture is, of course, the fact that monetary conditions and thus the broad outlines of financial policy in Luxembourg have been subject to the decisions of the monetary authorities in Brussels. When an inflationary financial policy has been adopted by the Belgian authorities, as in the 1920's, money incomes, prices, and costs have risen in Luxembourg as well as in Belgium; and when the Belgian authorities have adopted a deflationary policy, as in the 1930's, money incomes, prices and costs have fallen in Luxembourg as well as in Belgium.

The preceding paragraph states the essential monetary relationship which has in fact existed, but the details of this monetary relationship are complicated and have been the subject of acute controversy between the two governments. It is possible here to give only a brief and summary outline of them.*

Immediately before the first world war the legal money of account in Luxembourg was the Luxembourg franc and the *Banque Internationale de Luxembourg*, the chief bank in the country, had the right to issue its own franc notes up to a certain sum. The rate of exchange was fixed at 1.25 Luxembourg francs to 1 German mark; and in fact the main currency in circulation in the country was the German mark which exchanged for the Luxembourg franc at this fixed rate of exchange. During the first world war the Luxembourg government issued treasury notes expressed in terms of Luxembourg francs for the purposes of war finance; and in 1919 the main currencies in circulation in Luxembourg were 200 m. German marks, 16 m. francs of Luxembourg treasury notes, and 6.25 m. francs of notes of the *Banque Internationale de Luxembourg*. In 1919 the Luxembourg government issued 250 m. Luxembourg francs of new treasury notes with which it replaced at the

* A full exposition of this complicated problem can be found in Majerus, *op.cit.*, pp. 83-90; Hommel, *op.cit.*, pp. 115-129; and Paul Bastian, *Le Système Monétaire du Grand-Duché de Luxembourg*, Luxembourg, 1936, *passim*.

previous parity of 1.25 Luxembourg francs for 1 mark the 200 m. marks then in circulation.

Under the terms of the 1921 treaty of economic union, it was agreed that the main body of these treasury notes, which had been issued to replace the previous circulation of German marks, should themselves be replaced by Belgian franc notes at a par rate of 1 Belgian franc to 1 Luxembourg franc. For this purpose it was agreed that the *Banque Nationale de Belgique* should issue a loan of 175 m. francs in Belgium on behalf of the Luxembourg government, the proceeds of which would be used by the Luxembourg government to replace with Belgian currency 175 m. of the Luxembourg treasury notes then in existence. In addition, the Luxembourg government could, under the treaty of 1921, leave in circulation an amount of Luxembourg notes up to 25 m. francs. Any remaining excess of the issue of Luxembourg treasury notes would have to be withdrawn from circulation by the Luxembourg government out of its own resources of taxation or borrowing. The loan of 175 m. francs was issued by the *Banque Nationale de Belgique* at a rate of interest of 6 per cent; but under the treaty of 1921 the Luxembourg government was under an obligation to pay only up to 2 per cent on this loan, the difference of 4 per cent falling to the charge of the Belgian government.

Thus in effect under the treaty of 1921 Luxembourg was left with the Luxembourg franc as the legal money of account in the country and with the right of issue of a limited fiduciary circulation of 25 m. francs of Luxembourg notes. For the rest, which made up by far the greater part and the fluctuating part of the monetary circulation, the Belgian franc was in circulation at a parity of 1 Belgian for 1 Luxembourg franc. The Luxembourg government held the rapidly depreciating 200 m. marks which it had withdrawn from circulation, just as the Belgian government was left holding 6,000 m. marks from the German occupation of its territory. Under the treaty of 1921 the Belgian government undertook that if it reached agreement with Germany to obtain repayment for these marks, it would see that the Luxembourg government obtained similar treatment for the marks which it held.

This settlement was the subject of acute controversy between the two governments. It is not necessary here to enter into detail on the reasons for this. A very brief indication of the arguments on each side must suffice. The Luxembourg government felt that the Belgian government should have been willing simply to have increased the Belgian note issue by 175 m. francs, or to have accepted as legal currency in the area of the Union the existing Luxembourg treasury notes, without imposing the 2 per cent interest charge on the Luxembourg government for the

loan issued to redeem the treasury notes; for, it was argued, the Belgian currency area was in fact simply being extended by the addition of the Luxembourg area and the Luxembourg government was not participating in any share of the profits on its note issue made by the *Banque Nationale de Belgique*. On the other hand, the Belgian government was itself at this time engaged in issuing Belgian bonds on which it had to pay interest in order to consolidate part of the excessive supply of its own currency resulting from the war, and it felt that the Luxembourg government should also take a share in this burden of wholesome disinflation.

This controversy continued for many years. In 1926 there was an agreement between the two governments whereby the Belgian government gave to the Luxembourg government a share in the profits of the *Banque Nationale de Belgique* to an amount sufficient to offset the 2 per cent charge on the 175 m. francs loan payable by the Luxembourg government. This agreement was not implemented by Belgian legislation, but in fact the Luxembourg government ceased to pay the interest charge to the Belgian government.

The monetary settlement in 1921 was followed by an inflation in Belgium whose currency was not tied to gold until 1926. As a result of this the Luxembourg government argued that its right of fiduciary issue of Luxembourg franc treasury notes should be raised from 25 to 40 m. francs because of the depreciation of the gold value of the Belgian franc since 1921, the issue of Luxembourg treasury notes having in fact always remained above 40 m. francs since 1921 in spite of the provision of the 1921 treaty that it should be reduced to a maximum of 25 m. francs. The treaty itself did not expressly specify whether this limit was a limit set in terms of gold francs or of paper francs. Nor did it make clear whether the limit was to exclude or to include the fiduciary note issue of the *Banque Internationale de Luxembourg* which also was legal tender in Luxembourg. Both these points were a matter of controversy between the two governments.

In Luxembourg only the small issue of Luxembourg treasury notes and of the notes of the *Banque Internationale de Luxembourg* had legal tender. And the feeling of the Luxembourg people in favour of the maintenance of a national currency is shown by the fact that, although in 1929 a Luxembourg law fixed the Luxembourg franc at the same gold value as that which had been chosen for the stabilisation of the Belgian currency in 1926, yet in the same year an act was passed in Luxembourg whereby its government was empowered to create a Luxembourg currency of Luxembourg francs with its own gold reserve and gold backing. This law was, however, never put into force.

This question was at last regularised by a supplementary convention of 23rd May 1935 between the two governments. The Belgian franc had just been devalued in terms of gold. It was agreed that Belgium and Luxembourg should share in the consequential profit in terms of Belgian francs made by the *Banque Nationale de Belgique* on its gold holding. The profit was to be shared on the basis of their populations, i.e. on the same basis as that used for the sharing of their pooled revenue from customs and excise duties. The 175 m. franc loan issued in 1922 for the redemption of Luxembourg treasury notes was to be repaid in 1937, partly out of Luxembourg's share in the gold revaluation profit; and the remainder of the loan, except for the sum of 10 m. francs, would be repaid by the Belgian government. The Luxembourg government was to share retrospectively as from 1st January 1927 on the same population basis in the profits made by the *Banque Nationale de Belgique*. The 2 per cent charge payable by Luxembourg on the 175 m. franc loan of 1922 would for the period 1927 to 1937 be deducted from Luxembourg's share in these profits.

Under this convention of 1935 the Luxembourg government received the right to issue Luxembourg francs up to 100 m. francs; but in fact at this time the issue already exceeded 100 m. francs and it was agreed that this limit could be temporarily raised to 125 m. francs until October 1942. The *Banque Nationale de Belgique* was permitted to set up an agency in Luxembourg, a permission which Belgium had for long tried in vain to obtain. Moreover, Belgian franc notes, which since the formation of the Belgium-Luxembourg Economic Union had in fact, always been accepted by the Luxembourg treasury in payment of taxes etc. at a parity with the Luxembourg franc, were now also given the formal status of legal tender in Luxembourg; but as the Luxembourg franc had not been devalued as much as the Belgian franc, Belgian francs were to be legal tender in Luxembourg at a rate of 1.25 Belgian francs to 1 Luxembourg franc.

This alteration in 1935 in the par rate of exchange between the Belgian and the Luxembourg francs is a phenomenon of considerable interest. For it represented a sudden break in the relative values of two moneys, one of which (the Luxembourg franc) was the official unit of account and legal tender but was strictly limited in its total issue so that it represented only a small and fixed subsidiary amount of the actual currency in circulation, and the other of which (the Belgian franc) was neither the official unit of account nor, at the time, was legal tender but in fact represented by far the greater part of the actual currency in circulation in Luxembourg. It is necessary, therefore, to con-

sider the main effects of this change of parity upon the monetary position of Luxembourg.

The Belgian franc was in fact devalued by 28 per cent in gold content at the end of March 1935, when the Belgians finally left the "gold bloc" and gave up the attempt by internal deflationary measures to maintain the gold value of the franc in the face of deflation and devaluations in the other main trading countries of the world. At the beginning of April 1935 Luxembourg followed with a 10 per cent devaluation of the gold value of the Luxembourg franc, an action which resulted in a change in the value of the Luxembourg franc from 1 Belgian franc to 1.25 Belgian francs. That Luxembourg did not follow the Belgian devaluation completely owes its explanation largely to the previous history of the Belgian franc. Luxembourg, because of the previous close link between the two currencies, had in fact unwillingly had to take part in the great Belgian price and monetary inflation of the 1920's without partaking in some of the main benefits of such inflation since at that time none of the profits from the increased Belgian note issue accrued to the Luxembourg government; she had actually been just on the point of establishing a separate gold value for the Luxembourg franc in 1926, when the stabilisation of the Belgian franc in terms of gold made such action at least temporarily unnecessary; but when the further devaluation of the Belgian franc occurred in 1935 it was not altogether unnatural that Luxembourg should make the break from parity with the Belgian franc, even though in fact such action was probably unwise since in 1935 it was basically a matter of devaluing in order to avoid domestic deflation instead of, as in 1926, devaluing in order to accommodate an undesirable domestic inflation.

The effects of this change in the rate of exchange on the Luxembourg financial and economic position were broadly of three kinds.

In the first place, there was an important and somewhat arbitrary effect upon the relative values of different creditors and debtors according as whether particular assets or liabilities were legally fixed in terms of Belgian or Luxembourg francs. Those who happened at the time to have Belgian franc notes in their pockets lost relatively to those who happened to be holding Luxembourg notes. As we have already seen, the amount of Belgian notes in circulation greatly exceeded the amount of Luxembourg notes; but on the other hand the amount of deposit money built on this cash basis was expressed mainly in terms of francs without specifying either Belgian or Luxembourg francs. It was legally decided that where neither currency was expressly stated the debt must be considered to be fixed in terms of Luxembourg francs. In some cases banks and similar institutions which held their assets to a considerable

extent in Belgian francs and their liabilities predominantly in Luxembourg francs suffered an embarrassing loss and had to agree with their creditors to meet their obligations only over a period of years. It was the government savings institution, the *Caisse d'Épargne*, which was most severely hit; for all its liabilities were expressed in terms of Luxembourg francs and practically all its assets were invested in terms of Belgian francs. This loss was met partly from the previous profits made by the institution and partly from the proceeds of the increase in the issue of Luxembourg treasury notes which, as we have seen, was permitted under the financial agreement of 23rd May 1935.

The second main effect was upon the level of monetary costs and prices in the two parts of the Union. In Luxembourg wage rates and other costs were payable in terms of Luxembourg francs. For this reason costs of production in Luxembourg naturally rose relatively to costs of production in Belgium by reason of the 25 per cent increase in the price of the Luxembourg franc in terms of the Belgian franc. While the 10 per cent devaluation of the Luxembourg franc in terms of gold, and so also in terms of other outside currencies, had some effect in improving her competitive position in outside markets, the 25 per cent increase in the value of the Luxembourg franc in terms of the Belgian franc worsened by a greater amount her competitive position *vis-à-vis* her trading partner Belgium with whom her economy was so closely related. The effects of this deterioration in Luxembourg's competitive position were mitigated by the fact that steel made up such a large proportion of Luxembourg exports and the volume of steel exports was protected by the export quotas fixed under the existing international steel cartel. But in the case of Luxembourg's other miscellaneous exports the effect was important; and in fact subsidies had to be paid to some of these industries to enable them to face the worsened market conditions. Also in the case of many imports there was a considerable incentive for Luxembourg consumers now to purchase Belgian rather than home-produced goods. For these reasons the change in the exchange rate was necessarily followed by a difficult process of deflation of domestic prices and costs in Luxembourg relatively to Belgian prices and costs.

Thirdly, the change in the exchange rate had an adverse effect upon the Luxembourg budget quite apart from the cost of the industrial subsidies to which reference has just been made. As we have seen, the revenue from customs and from the unified excise duties was paid into a common pool and distributed between the Belgian and Luxembourg governments in proportion to the populations of the two countries. In so far as these duties were specific duties they were fixed in terms of

Belgian francs. This meant that in terms of Luxembourg francs there was a considerable fall in the total revenue from customs and excise duties and so in the receipts of the Luxembourg budget; and it so happened that this fall in revenue in the Luxembourg budget was intensified by the simultaneous alteration in the formula for the distribution of the unified alcohol duties which meant that a smaller proportion of them went to the Luxembourg government. (See Section X below).

Such were the main effects of the change of exchange rates in 1935. They were, however, once-for-all adjustments. They do not alter the fact that during the whole of the period 1921-1939 the monetary arrangements for the Belgium-Luxembourg Economic Union were such that there was no technical balance-of-payments problem of transferring money from the one to the other partner country. The Luxembourg franc was the unit of account and legal tender; but as a means of payment Luxembourg notes were fixed in amount and were small in amount as compared with Belgian notes; these Belgian notes were acceptable as well as Luxembourg notes in making payments to the Luxembourg treasury; they exchanged, therefore, always at a fixed rate in terms of Luxembourg notes (although there was a sharp once-for-all break in this rate of exchange in 1935); and on the basis of this currency circulation of Luxembourg and Belgian franc notes a banking structure of deposit money had been built up with assets and liabilities expressed sometimes in terms of Luxembourg and sometimes in terms of Belgian francs. With such a system it was, of course, always possible for people in Luxembourg to make net payments to people in Belgium by sending to Belgium some part of the Belgian currency circulating in Luxembourg. Or people in Belgium could make payments to people in Luxembourg by sending additional supplies of Belgian currency into Luxembourg.

VII. SOME SECONDARY DIFFICULTIES OF ECONOMIC INTEGRATION

The application of the principle of complete free-trade between two sovereign countries with different domestic, social, and economic institutions and legislations is bound to cause difficulties. In subsequent sections of this essay we shall analyse in some detail a number of major instances of exceptions to the principle of free-trade between the two partners, exceptions which were consciously made for the purpose of mitigating clashes of interest which would otherwise have occurred. But in addition there were a number of less important cases in which it was difficult to find the exact application of the free-trade principle—

in some cases not so much because of direct clashes of interest as because of the existence of differences in domestic institutions and legislation. We will briefly enumerate a few examples of such difficulties.

A good example of such a difficulty was the application of the principle of equal treatment in the granting of public contracts to the nationals of both countries. It was found difficult to ensure that all local authorities observed this principle. Moreover, with different institutions and policies in the two countries it was not always easy to say exactly what equal treatment meant. For example, differences in the social security provisions in the two countries gave rise to some difficulties. It was admitted that if an industrialist had paid social charges in his own country he would not have also to pay under public contracts the social charges levied in the other country. But in Luxembourg, as opposed to Belgium, there was no legal obligation on the part of industrialists to pay family allowances, though many in fact did make such payments. The question thus arose whether they should pay a second time when submitting tenders for contracts in Belgium.

Differences between Belgium and Luxembourg legislation on the question of retail commerce have also led to some difficulties. Luxembourg, but not Belgium, had a law forbidding the hawking of wares by itinerant salesmen. The treaty of economic union of 1921 expressly allowed a partner to forbid such hawking of goods in its territory; nevertheless, the fact that this control existed in Luxembourg but not in Belgian domestic legislation meant that Luxembourg traders visiting Belgium had more freedom to seek orders than did Belgian traders visiting Luxembourg. Moreover, legislation in Luxembourg forbade merchants and their commission agents from seeking orders from persons who do not deal in the goods which they offer for sale. Since 1932 it was forbidden in Luxembourg to open a new trade without authorisation. No such restrictions existed in Belgium to impede the attempts of Luxembourg traders to sell in Belgium.

At the time of the formation of the Economic Union there existed in Belgium a turnover tax and in Luxembourg a sales tax. Broadly speaking, these systems imposed a small percentage tax on every sale or transaction within the country; export sales were exempt from tax; but on the other hand imports were subject to an import tax equivalent to the tax levied on other transactions in the importing country. Thus a product which was sold by a Belgian to a Luxembourger would in principle be subject to the Luxembourg and not to the Belgian tax. This meant that a control must be exercised over imports into each of the partner countries coming from the other partner in order that this general import tax might be levied on them. This control at the com-

mon frontier could be removed only if the two taxes (like other excise duties) were unified into a single tax system, so that the tax was levied in both countries at the same rate on the same principle on all sales whether to a Belgian or to a Luxembourger, the revenue from the tax being paid into a common pool for distribution between the two countries in proportion to population or on some other agreed basis. But this unification would involve an equalisation of the rates of tax in the two countries; and this could not be achieved mainly because Belgium relied much more than Luxembourg on this tax to raise revenue and therefore imposed appreciably higher rates of tax. The Belgians did not wish to lose the budget revenue and the Luxembourgers did not wish to raise this tax burden on the general level of prices of goods and services sold.

But in addition to the general difficulty of unification because of differences in the rate of tax, particular cases of double-taxation or of discrimination between Belgians and Luxembourgers could arise because of differences in the rules and regulations for the administration of the turnover taxes in the two countries. In a protocol of 23rd May 1935 on the subject the two governments agreed to remove one or two minor anomalies that had entered into the system. For example, goods supplied by a Belgian firm to one of its branches in Luxembourg were under Luxembourg law subject both to import duty and sales tax; under Luxembourg law certain domestically produced products (flour and chemical fertilisers) had been exempted from the sales tax but imports from Belgium still paid the import duty; and, on the other side, certain metal products supplied by Belgian producers for the production of exports were exempt from Belgian turnover tax, though Luxembourg suppliers of similar metals for the same purpose were not exempt from the duty on import into Belgium; a Belgian order had removed for foreign products the exemption from turnover tax previously given on all sales to Belgian public authorities, which meant that direct sales from Luxembourg to such authorities lost this exemption which Belgian suppliers still enjoyed. Such anomalies could be removed. But, as we have seen, agreement could not be reached on the broader question of unifying the Belgian turnover tax and the Luxembourg sales tax into a single common tax.

The treaty of economic union of 1921 contained the usual provisions which enabled each partner to control imports on grounds of public safety, health, and so on. This power was in fact used by Luxembourg to exercise a strict control over the import of cattle from Belgium.

These are examples of the type of secondary problem which is bound to arise when two or more sovereign States with separate and distinct

domestic regimes in social, economic, health, and similar matters, attempt to institute a common market for goods and services between them. But they do not in themselves constitute really serious derogations from the principle of the single common market. We must turn now to a discussion of the few really important difficulties of this kind which arose in the formation of the Union.

VIII. THE AGRICULTURAL PROBLEM

Before the first world war Luxembourg had been a member of the German Zollverein in which agricultural production had been protected, whereas during the same period Belgian agriculture had not been protected. The transfer of Luxembourg's economic link from Germany to Belgium after the first world war, when Belgian agriculture continued to be subject to free competition from the outside world, would thus have involved a disturbance of Luxembourg peasant farming which it was not possible to contemplate.

French agricultural production after the first world war also continued to enjoy considerable protection; and this was one reason why there was a strong, indeed a predominant, desire in Luxembourg after the first world war to make the new economic link with France rather than with Belgium. But when, primarily for political reasons, it became clear that the tie must be with Belgium, it became inevitable that the treaty of economic union should contain some special provisions for Luxembourg agriculture.

As far as bread grains were concerned, the solution adopted was on the following lines. A record was to be kept of the price of bread grains in Antwerp (as representative of the free Belgian market) and in Metz in Lorraine (as representative of a market which before the war had also been within the protected German customs area, which had been the decisive local market for Luxembourg before the war, and which was now within the protected French customs area). The difference in price in these two markets was to be multiplied by the total output of bread grains in the two countries over the same period. An amount of money equal to this sum was to be withdrawn from the common pool of customs and excise revenue to which reference has already been made. This part of the revenue from customs and excise was to be divided between Belgium and Luxembourg in proportion to the acreages sown to bread grains in the two countries, instead of in proportion to the total population of the two countries. The special sum paid out of the pool of customs and excise revenue to Luxembourg was available

for the Luxembourg government to use for the subsidisation of acreages sown to bread grains in Luxembourg.

A limit was set to the amount of the common customs and excise revenue which would thus be made available to Luxembourg for agricultural subsidies by setting an upper limit of 6 francs per 100 kg. to the differential between Antwerp and Metz prices which would be used for the above calculation of the amount to be withdrawn from the common pool of customs and excise duties. If subsequently import duties were imposed on the import of bread grains into the Belgium-Luxembourg Economic Union, then the limit of the price differential to be used for this calculation was to be set at 6 francs less the import duty so levied. With the development of the great depression in world agricultural prices, this upper limit to the price differential was raised from 6 to 18 francs at the end of the 1920's. Subsequently, in 1935 as a result of the devaluation of the Belgian franc, this limit was raised to 22.5 Belgian francs.

Thus, broadly speaking, the arrangement was one whereby, subject to an upper limit, the Luxembourg government could withdraw from the common pool of customs and excise revenue an amount of money which would enable a subsidy to be paid to make up to the Luxembourg producer of bread grains the difference between the market price in the Belgian market of Antwerp and the market price in the protected French market of Metz. The amount of money so received by the Luxembourg government was not, of course, all a net gain at the expense of the Belgian government, since if this sum had not been withdrawn and divided between them according to their outputs of bread grains it would have remained in the common pool for division between them according to their populations. But acreage sown to bread grains in the protected economy of Luxembourg was much higher in proportion to total population than it was in the unprotected Belgian economy. The acreage sown to wheat in Luxembourg was about $9\frac{1}{2}$ per cent of the total in the Belgium-Luxembourg area and that sown to rye was about $5\frac{3}{4}$ per cent of the total. On the other hand the total population of Luxembourg was only about $3\frac{1}{3}$ per cent of the total population of the Union. There was thus a considerable net gain of revenue to the Luxembourg government.

The way in which this arrangement in fact operated to support Luxembourg agriculture is clear from the figures on the opposite page.

As a result of the onset of the great depression in 1930, with its particularly severe effect upon world agricultural prices, measures were taken for the support of agriculture in both Belgium and Luxembourg. Some of the measures, as will be shown below, were such as to break

	<i>Luxembourg special receipts of revenue from the common customs pool in respect of bread grains.</i>	<i>Excess over what Luxembourg would have received on a population basis.</i>	<i>Rate of subsidy paid by Luxembourg out of the special receipts. Luxembourg francs per hectare sown to bread grains.</i>
	<i>Belgian francs (million).</i>		
1923	3.3	1.8	160
1924	2.8	1.5	133
1925	1.8	1.0	83
1926	1.8	0.9	74
1927	2.6	1.1	97
1928	2.7	1.1	104
1929*	9.2	4.0	362
1930	9.4	3.2	382
1931	10.1	3.7	520
1932	9.7	3.2	389
1933	9.6	3.1	371
1934**	11.1	3.9	327
1935	11.2	4.9	351
1936	14.0	5.9	396
1937	12.4	6.6	368
1938	13.8	7.2	341
1939	10.6	5.8	319

* Upper limit to the price differential raised from 6 to 18 francs.

** Upper limit to the price differential raised to 22.5 Belgian francs.

the common market for such products in Belgium and Luxembourg. In order to understand the problems which arose for the Union, it is useful to consider briefly first the Belgian and then the Luxembourg agricultural policies during these years.

Until 1930 there had been practically complete freedom of import of agricultural products into Belgium. The new Belgian tariff which was imposed after the first world war contained a customs duty on the import of oats; but this was the only exception to the free-trade principle in the agricultural field. But with the onset of the world economic depression in 1930 the position was transformed.

In 1930 a duty of 1 franc a kilo was imposed on imports of sugar; and subsequently import duties were imposed on a wide range of agricultural imports. Belgium was a producer of finished agricultural products—in particular of animal products and vegetables—based to a considerable extent upon imported feeding stuffs and fertilisers. The new

import duties were imposed largely on such finished products as meat, milk, butter, fruits, and vegetables.

But still more important was the system of licensing of such agricultural imports and their restriction by quantitative quotas which was made possible by Belgian legislation in 1931. Such quantitative restrictions naturally gave rise to a discrepancy between the low external price at which foreign producers were ready to 'dump' their surpluses on the Belgian market and the higher domestic Belgian prices, which it was the purpose of the restriction to support. In a number of cases this margin was mopped up by the Belgian government through the charge of a special fee for the issue of the licences to import. There was, however, considerable doubt whether the legislation of 1931 really permitted the imposition of such fees; and in 1934 new legislation was passed which made provision for licence fees as well as for quantitative import quotas. After 1934 the imposition of licence fees became a common feature of Belgian agricultural import quotas.

This system covered many products, particularly meat, dairy produce, fruit and vegetables. Butter is a good instance of the system. Imports of butter were restricted by quota; there was some regular customs duty on its import, and there was in addition an import-licence fee, the level of which was varied according as market conditions changed, so as to absorb the price margin between the supply price of, for example, Dutch and Danish butter and the price ruling in the Belgian market. This protection of Belgian butter production was reinforced by a restriction on imports of the closely competing product, margarine.

Most of these quota schemes were in fact operated as common and joint Belgian-Luxembourg schemes for the restriction of the imports of the foreign products into the area of the Union as a whole. Where this was the case, the revenue raised from the levying of import-licence fees was paid into the common pool of customs and excise duties for distribution between the two governments in proportion to the populations of the two countries. But, as we shall see below, some of the import restriction schemes were operated separately by each of the two partner countries with the necessary consequence of a control of the trade over the common frontier between them. In such cases where either partner had a separate autonomous scheme for the control of a particular import, the revenue from any import licence fee was also treated as a separate revenue which accrued wholly to the country imposing the separate control.

The Belgian system of agricultural protection which was devised in the 1930's was thus fundamentally based upon the regulation of imports into the country by import duty, by quantitative import quotas,

and by import licence fees. But there were one or two instances of protection of domestic agricultural production by other means.

Thus, from 1933 onwards compulsory milling ratios were introduced under which the Belgian millers had to include a certain minimum proportion of home-grown Belgian wheat in the flour sold for the production of the Belgian loaf.

This valorisation scheme for bread cereals in Belgium was supported by a system of acreage subsidies paid for the production of various cereals in Belgium and the funds for these subsidies were raised by a special levy on the import of certain cereals into Belgium, the proceeds of this levy not being payable into the common Belgium-Luxembourg customs pool because there were separate and autonomous schemes for the valorisation of cereals and so for the control of their import in the two partner countries. A subsidy was also paid on the production of certain cheeses in Belgium.*

In the 1930's further measures were also taken for the protection of Luxembourg agriculture. These additional measures took two forms: (1) the fixing of minimum proportions under an order of January 1930 for the amount of domestically produced cereals which the Luxembourg millers had to include in their use of grains for milling, and (2) the fixing of minimum prices to be paid for cereals produced in Luxembourg. These two measures were closely connected, since the maintenance of the minimum prices could be achieved by increasing the proportions of domestically produced grains which the millers had to purchase. Initially the minimum incorporation rates were low. At first at least 15 per cent of the contents of the Luxembourg loaf had to consist of Luxembourg bread grains (10 per cent wheat and 5 per cent rye). But these rates were progressively raised until by October 1938 at least 85 per cent of the contents of the Luxembourg loaf had to consist of domestically produced bread grains. The protection given to Luxembourg against Belgian cereals by the setting of minimum prices in Luxembourg under the protection of these minimum incorporation rates can be seen on page 24 from the figures of prices (expressed in Belgian francs for 100 kg.) ruling in Luxembourg and in Belgium for wheat and rye.

We have already referred to the supplementary convention of 23rd May 1935 between the governments of Belgium and Luxembourg on the setting up of a common regime for the quantitative regulation of the trade of the two countries. The treaty of economic union of 1921 contained no specific provisions about the regulation of imports into the

* See M. J. Forget, "Evolution Economique de l'Agriculture Belge au Cour d'un Siècle," *Revue de l'Agriculture*, Ministère de l'Agriculture, Brussels, 2me. Année, No. 10 (October 1949), pp. 866-870.

	LUXEMBOURG.		BELGIUM.	
	<i>Wheat.</i>	<i>Rye.</i>	<i>Wheat.</i>	<i>Rye.</i>
1934	105	70	66	71
1935	105	70	74.4	60.8
1936	120	85	96	78.4
1937	150	105	111.2	100
1938	150	110	97.1	72

Union by licensing and quantitative quotas. The convention thus regularised a position which had grown up with the inception of quantitative import controls. The basic principle of the convention was that, like customs duties, import-quota schemes should also be imposed jointly for the Union as a whole with freedom of movement of the restricted products between the partner countries within the Union. But there were certain exceptions to this principle, which, particularly in view of the Luxembourg agricultural problem, regularised the maintenance of controls over the flow of agricultural products between Belgium and Luxembourg. Luxembourg was authorised to regulate the inflow from Belgium of potatoes in the season from September to March, of eggs in the season from March to September, and of apples in the season from September to January, provided that the Belgian government had failed after a request from the Luxembourg government to take sufficiently severe measures to limit or to tax the import of these products from the outside world into the area of the Union. Similarly, the Luxembourg government was authorised to limit the import of butter from Belgium whenever the Belgian government reduced the special licence fee on butter imports below the then existing level of 7.50 francs a kilo or increased the quota of butter imports into the Union above the corresponding monthly figure for 1934; the Luxembourg government could also limit imports from Belgium of pigs and pig meat when the price of pigs fell below 5.50 francs a kilo, and of beef and beef animals when the price fell below 5.50 francs a kilo, on the Belgian market. But in all these cases in granting import licences the Luxembourg government was to give preference to imports from Belgium. As the prices of these products remained below these stated prices between 1935 and 1939, the Luxembourg government did in fact continue to restrict imports of these products both from third countries and from Belgium during this period. In the case of butter she not only restricted imports, but also raised a tax on the domestic production of milk and butter and used the proceeds to subsidise the export of butter, including exports to Belgium.

Under the convention of 1935 each government was authorised independently to regulate imports of cereals onto its markets from third countries if it had a domestic regulation or valorisation scheme for the cereal in question; and each government was similarly authorised to control imports of the cereals concerned (or of close substitutes for those cereals) from the other partner if the effect of its domestic valorisation scheme was to cause differences in the market conditions in the two countries which made some such protection necessary. This enabled the two countries to control the movement of cereals across the common frontier so that they could effectively impose their own separate national schemes which enforced the inclusion of minimum proportions of home-grown cereals in the flour milled within the country.

One other relatively minor exception to the general provisions of the treaty of economic union of 1921, the purpose of which was to protect Luxembourg agriculture, may be mentioned. Much of the iron-ore deposits of Luxembourg were worked under a concessionary regime under which the deposits themselves were the property of the State but were let out at certain rents to the operation of private enterprise. The workings of these iron-ore deposits produce basic slag which is a valuable agricultural fertiliser. The private holders of the rights of operating the State iron-ore deposits were, under the terms of their concessions, under an obligation to provide this basic slag to the Luxembourg State partly at world prices and partly at a specially low price, which has enabled the Luxembourg government to provide this fertiliser to Luxembourg farmers at a price 50 to 60 per cent below the world price. Under the terms of the 1921 treaty of economic union there was a general provision that the two partners should consult together to set up common schemes if one government wished to operate a special price regime for a particular product; but this supply of basic slag at a special price to Luxembourg farmers was specially exempted from this provision.*

IX. LUXEMBOURG WINES

A second problem which required special consideration under the Belgium-Luxembourg Economic Union was the treatment of Luxembourg wines. Before the first world war within the German Zollverein Luxembourg had had a substantial market for her wines in Germany. This market was no longer available to her. The problem of the readjust-

* The above description of the agricultural exceptions to the principles of the treaty of economic union is based upon Hommel, *op.cit.*, pp. 110-115, and Hemmer, *L'Économie du Grand-Duché de Luxembourg*, Première Partie. Luxembourg. 1948. Pp. 84-85 and 116-119.

ment was somewhat eased by a provision of the Treaty of Versailles which required Germany to admit 50,000 hls. of Luxembourg still wines free of duty annually up to 1925; and in negotiating the commercial treaty of 1925 with Germany, Belgium attempted, but with very limited success, to get favourable treatment for Luxembourg wine in the German market.

A major readjustment of the Luxembourg wine industry was necessary. Belgium, unlike France or Germany, had no significant wine industry of her own; and in this respect the Luxembourg wine industry might be expected to have had a more favourable opportunity for development when she had free and preferential entry to the Belgian market than when she had free and preferential entry to the French or the German market. But this advantage was offset by other facts. In the first place, Belgium was a small market compared with the French or German market, both because of the size of the population and also because beer rather than wine was the drink of the country. But, in the second place, the pre-war Luxembourg wine was not in fact a finished table wine, but was sent to Germany rather as a raw material to be used in the preparation of finished wines. The Luxembourg industry was thus faced with the twofold task of altering the nature of its product by applying certain ameliorative processes to it and of building up a taste for Luxembourg wine among the Belgian population.

Two special provisions were introduced into the treaty of economic union of 1921 to help to deal with this problem. In the first place, the treaty expressly forbade the imposition of any excise duty on "natural non-sparkling indigenous wines made from fresh grapes." In the second place, artificial fruit-juices (which might compete with Luxembourg wine) could not be traded within the Union unless their containers clearly stated the nature of the product which was traded.

These provisions were intended to enable the Luxembourg wine industry to build up a market in Belgium. But Luxembourg wines continued to encounter some difficulties in the Belgian market. An industry grew up in Belgium for the working-up of crude wines; this affected the nature of Luxembourg wines in Belgium and led to an undeserved distrust of them among Belgian consumers. A Belgian law operated against the abuse of trade marks in the case of French and other foreign wines; but this protection was not at first available for Luxembourg wines because the Luxembourg government had not informed the Belgian government of the names which it desired to have protected. In the late 1930's, however, the Luxembourg government took the steps necessary to establish the names of the Luxembourg wines which should receive protection under the Belgian legislation against the abuse of

trade marks. Luxembourg wines had also to meet the competition of artificial fruit-juices in Belgium. The relevant provision of the treaty of economic union prevented flagrant cases of abuse; but the small Belgian retailer who sold as wine fruit-juices mixed with wine was not effectively controlled.

The provision of the treaty of economic union that Belgium should not impose any excise duty on the types of wine produced by Luxembourg was, of course, of great help to the Luxembourg producers. In 1926 Belgium in fact imposed a consumption duty on all wines, and Luxembourg wines were at first subject to this tax on passing into Belgium. But in 1927 Belgium removed this tax on Luxembourg wines, which—in preference to other foreign wines—were once more free of tax in the Belgian market. At the time of the institution of the economic union the excise duty (payable by foreign but not by Luxembourg wines) was 60 francs per hl. Luxembourg continued to press that this Belgian excise should be raised and by 1938 it stood at 160 francs per hl. In 1938 the Belgian government agreed to pay annually 1.5 m. Belgian francs for the subsidisation of Luxembourg wine production on condition that the average price of Luxembourg wine did not exceed 3 Luxembourg francs a litre and that the Luxembourg government did not reduce the payments which it was making in support of its wine production (e.g. in the form of subsidies to make up for loss of income of the vineyards for the first three years after replanting with improved vines or to help in obtaining improved equipment). This Belgian subsidy was paid for the first and only time in 1939.*

X. THE TAXATION OF ALCOHOL

A special problem of a rather different type in the Belgium-Luxembourg Economic Union has been presented by the trade in alcohol between the two countries. Alcohol is a product which is subject to extremely high rates of duty; thus in Belgium in 1934 the price ex-tax was about 2.50 francs a litre, on which was imposed an excise duty of 27 francs plus a consumption tax of 30 francs or a total tax of 57 francs which is 23 times the value of the product. In such circumstances where the market price of the product is mainly made up of tax it is of special importance that the taxes should be imposed at the same rate and should be enforced with the same degree of severity within the countries forming an economic union, if free trade between them in the product is to lead to fair and economic competition between them.

* The above account of the problem of Luxembourg wines is based upon Hommel, *op.cit.*, pp. 103-108; Hemmer, *op.cit.*, pp. 183-198; and Majerus, *op.cit.*, pp. 78-81.

But unfortunately in the case of alcohol this last condition was conspicuous by its absence. In both countries alcohol was produced partly in small agricultural distilleries which were difficult to control and in large industrial distilleries which could be readily controlled. Before the formation of the Union the Belgian authorities had pursued a policy which, in order to make possible a strict control of the excise, had successfully brought about a concentration of the distillation of alcohol on a small number of large industrial distilleries. This policy had been carried out partly by the offer of compensation in 1902 by the Belgian government to agricultural distilleries which were prepared to be closed down and partly by a very strict definition of what constituted an 'agricultural distillery' eligible to benefit from the laxer controls appropriate to such small and scattered enterprises.

In Luxembourg, on the other hand, there had been no attempt to close down existing agricultural distilleries and an agricultural distillery was much more laxly defined. As a result in Belgium in 1932 there were 26 industrial distilleries and only 8 agricultural distilleries, whereas in Luxembourg there were some 1,000 agricultural distilleries and 3 industrial distilleries.

In Belgium the excise duty was levied on the actual production of alcohol flowing through accurate measuring vessels. In Luxembourg a few distilleries possessed these accurate instruments, some possessed rather less precise counters, and the large number of agricultural distilleries were subject to a much laxer system altogether. They were taxed on an output estimated from the materials which they had used; and the large number of distilleries together with the small number of excisemen meant that even this control was not too strictly enforced.

For these reasons it was not considered possible in 1921 to unify the rates of duty, pay the proceeds into the common pool of revenue from customs and excise duties, and to leave the trade between the two partners free in the case of alcohol as in the case of other products. By the treaty of economic union of 1921 Luxembourg undertook in the case of the non-pooled excise duties (i.e. principally in the case of alcohol) the twofold duty of conforming her legislation as far as possible to the Belgian legislation and of imposing an excise at least equal to the rate of Belgian excise in force at the time of ratification of the treaty.

The application in Luxembourg of excise duties equal to the Belgian duties was complicated by the fact that the eight agricultural distilleries in Belgium were by a law of 1902 allowed a reduction of 16-20 centimes a litre from the normal excise duty. By a law of 1924 the Belgian government was empowered to raise this rebate to 1.80 francs a litre on certain conditions, namely, that the industrial distilleries should denounce

an arrangement whereby they bought up the output of the agricultural distilleries at a specially remunerative price. This condition was not fulfilled and the higher rebate was not applied in Belgium. But through a misunderstanding it was applied in Luxembourg whose agricultural distilleries thus enjoyed both a larger rebate in the rate of duty and a much laxer system of control. In 1932 some 4/5 of the Luxembourg output enjoyed the special tax reduction of 1.80 francs. Moreover, in 1926 Belgium imposed a consumption tax of 8 francs a litre on alcohol, subsequently raised to 30 francs a litre. This tax was not imposed in Luxembourg and was therefore levied at the common frontier on the import of alcohol from Luxembourg into Belgium. But this put a very heavy premium on the smuggling of Luxembourg alcohol into Belgium across an otherwise loosely controlled frontier.

Partly as a result of these advantageous tax conditions under which the Luxembourg distilleries worked, between 1923 and 1932 the output of Belgian distilleries fell from 28,680 to 16,680 and of Luxembourg distilleries rose from 451 to 2,563 kl. at 100°.

The seriousness of this position was not merely that high-cost Luxembourg alcohol was cutting out lower-cost Belgian alcohol, but that as a result of this the Belgian budget was losing an important source of revenue to the Luxembourg budget since the excise duties on alcohol were not pooled. This last feature of the problem was temporarily solved in May 1929 by a convention, valid for 5 years, under which the excise duties from alcohol were pooled; but the pooled revenue from these excise duties was divided between the two governments not, as in the case of other duties, on the basis of population but in the shares of 8/9 to Belgium and 1/9 to Luxembourg. In a protocol to this convention the Luxembourg government undertook to make its control of agricultural distilleries as effective as possible and to apply the special agricultural regime only to agricultural distilleries which effectively served the interests of agriculture.

A further regularisation of the situation was brought about by a convention of 23rd May 1935 between the two governments. This confirmed the principle of a special common pool for the excise duties on alcohol but it reduced the preferential treatment which Luxembourg was then enjoying in the distribution of the revenue from the alcohol duties. In future only one-half of this revenue was to be distributed on the basis of 8/9 to Belgium and 1/9 to Luxembourg; the other half was in future to be divided on the normal population basis, i.e. 28/29 to Belgium and only 1/29 to Luxembourg. This convention contained further provisions to safeguard Belgian distilleries from uneconomic competition from Luxembourg agricultural distilleries. Certain rules for

the control of Luxembourg agricultural distilleries were agreed in an annex to the convention. Luxembourg further agreed that in the case of her agricultural distilleries which were not subject to the laxer system of taxation (of an indirect assessment of output through an estimation of materials consumed) the reduction of excise duty should not be allowed at a higher rate than that in fact enjoyed by the Belgian agricultural distilleries—subject to certain minimum reductions (of 0.9 francs per litre on production not exceeding 20,000 litres a year and of 0.6 francs a litre on production over and above that figure) to which such Luxembourg distilleries would in any case be entitled provided they had been set up before 1933. It was agreed that in Luxembourg all distilleries producing more than a certain minimum output should be subject to the stricter regime of taxation on the basis of a direct control of their output, and that this stricter regime should also be applied to the smaller distilleries if their output was not in fact based exclusively upon certain agricultural products enumerated in the convention. In any case the Luxembourg distilleries which continued under the laxer system of taxation were not thereby to be allowed in fact to be assessed on an output which varied by more than 10 per cent from their true output, and they would not enjoy the 0.9 or 0.6 franc rebate of duty allowed to the Luxembourg agricultural distilleries which were subject to the stricter method of assessment. At the same time a quota of 2,000 kl. of alcohol (of 50% at a temperature of 15°) was set on the export of alcohol from Luxembourg to Belgium. Finally, the Luxembourg government agreed to impose a tax on the consumption of alcohol in Luxembourg which would be raised by successive stages in 1935, 1936, and 1937 until it was as high as the Belgian consumption tax. The revenue from the consumption tax in each country was not to be pooled, but was to accrue directly to the government of the country of consumption.*

XI. THE IRON AND STEEL INDUSTRIES

The steel industry also presented some special problems in the formation of the Belgium-Luxembourg Economic Union. It also had to face considerable readjustment. Before the first world war when Luxembourg was part of the Zollverein, the industry in Luxembourg was based upon the import of coke from the Ruhr and the sale of pig-iron for further manufacture in Westphalia. By the Treaty of Versailles the problems of transition for Luxembourg were somewhat mitigated by the

* The above discussion of the problem of the trade in alcohol is based upon Hommel, *op.cit.*, pp. 92-103.

obligations put upon Germany of supplying Luxembourg on the pre-war scale with coke and of taking certain Luxembourg supplies of iron and steel on the pre-war scale duty-free until 1925, though the economic chaos and low purchasing power in Germany removed much of the advantage to Luxembourg of this latter obligation. In fact the Luxembourg industry started upon a successful policy of shifting its output from pig-iron to more highly finished products through the development of her own steel-making industry.

In general, as we have seen, the Belgium-Luxembourg Economic Union was a union between a predominant partner and a relatively small partner. But in the case of steel this was not so. Whereas the Luxembourg population in the 1920's made up only about 3 per cent of the total population of the Union, the Luxembourg output of iron and steel made up practically 50 per cent of the Union's output.

This was in fact an industry in which Belgian producers were as disturbed at the prospect of competition from Luxembourg as the Luxembourg producers were of competition from Belgium. The Belgian steel industry opposed the Belgium-Luxembourg Economic Union; it was argued that since 3 tons of iron ore and only 1.3 to 1.4 tons of coke were required to make a ton of pig iron, the Luxembourg industry had a clear advantage of transport costs in possessing its own iron ore while Belgium possessed only coal; it was further argued that the Luxembourg industry was better equipped and enjoyed the advantage of lower wage rates. The Belgian industry in these circumstances was afraid of losing its tariff protection against Luxembourg and also of losing important preferential railway rates which Belgian, as opposed to foreign, iron and steel products had enjoyed on the Belgian railways.

The Luxembourg industry, on the other hand, argued that it was at a disadvantage because in fact it had to import a large amount of foreign (Lorraine) ore to mix with its domestic ore as well as having to import all its coke; that it had to export 90 per cent of its product while Belgium enjoyed a substantial and expanding home market; and that it had worse railway connections than the Belgian industry.

As a result of this dispute, the treaty of economic union of 1921 provided for the setting up of a special committee of an equal number of Belgian and Luxembourg representatives with the unfortunately vague task of finding a proper equilibrium for the conditions of supply of raw materials and flow of the final product in the steel industries of the two countries; this proper equilibrium was, if necessary, to be assured by the fixation of preferential railway rates; and if the special committee set up for this purpose could not reach agreement, the matter was to be

referred to the special machinery of arbitration which was envisaged under the treaty.

In Luxembourg the view had been held that when the treaty of economic union came into force the Belgian railway rates would be so adjusted as to remove the existing discrimination against Luxembourg iron and steel products, and that the preferential tariffs would be re-introduced only if it were ultimately determined, under the provisions of the treaty which have just been outlined, that this was necessary for the preservation of a proper equilibrium in the industry. But in fact the Belgian railway preferential rates were maintained, the Belgian view being that they would be modified only if the special committee found that they were not necessary. There were further causes of dispute about the interpretation of these provisions of the treaty, the Belgians maintaining that the attainment of a "proper equilibrium" involved an equalisation through preferential railway rates of all the raw material and transport costs of the two industries and the Luxembourg interests maintaining that the preservation of a proper equilibrium for "the conditions of supply of the raw materials and of flow of the product" implied only the equalisation of transport costs. Moreover, there were serious disagreements about the calculation of costs.

There were heated and inconclusive discussions in the special committee which met as soon as the treaty was signed. Finally, in 1926 appeal was made to the arbitration procedure envisaged for the settlement of disputes under the treaty. An arbitral body was set up to investigate the conditions of supply of the raw materials and of the flow of the final products in the two industries and to determine what changes, if any, were required in the special railway tariffs in either or both of the two countries to ensure a proper equilibrium. The arbitrators were given four months to reach a decision; but in fact at the end of two years they were still busily engaged on the calculation of costs. This is the only case in which the arbitration provisions of the treaty have in fact ever been used.

Finally, in 1929 the two governments reached an agreement whereby the special preferential tariffs given on the Belgian railways to the Belgian products should be extended to the products of the Luxembourg producers as well and, in return, the Luxembourg producers abandoned their claims (which had been an important obstacle in previous attempts to reach agreement) for compensation for the higher rates which they had had to pay on the Belgian railways during the preceding seven years of the operation of the treaty of economic union. As the general provisions of the treaty of economic union of 1921 forbade any discrimina-

tory treatment, such as preferential railway rates, this agreement in fact applied the general provisions of the treaty to the steel industry from 1929 onwards, as if there had in fact been no special provisions in the treaty relating to that industry.*

In fact the formation of the European Steel Cartel in 1926 had greatly altered the conditions of competition of the Belgian and Luxembourg steel industries, both of which were members of the Cartel. Each member country now had a fixed quota for its production of crude steel, a fine being imposed on all production above the national quota and a subsidy being received on the amount by which national production fell below the quota. The keenness of competition in steel markets between the two partner countries was thus greatly diminished. In the course of 1930 with the development of the world economic depression, the international steel cartel broke down. But it was revived again in 1933 on the basis of particular export quotas for each of the main steel products, with an overriding export quota for the crude steel content of all exports, for each member country. Once more the keenness of competition between the Belgian and Luxembourg steel industries was blunted; and on this occasion the Belgian and Luxembourg steel producers had an additional special agreement among themselves for the division of the Belgium-Luxembourg domestic market between them.

In 1935 the iron and steel industry became the occasion for yet one more special exception to the operation of the general principles of the treaty of economic union of 1921. We have already mentioned the convention of 23rd May 1935 setting up a common régime for the quantitative control of imports into the area of the Union; under this a special exception was made for coal and coke which were essential raw materials for the iron and steel industry and which Belgium but not Luxembourg could produce for herself. It was, therefore, agreed that, if Belgium restricted imports of coal and coke, the Luxembourg government need not restrict imports of these products into Luxembourg as part of a common programme of import restrictions. But if the Luxembourg government should opt out of any such programme for the restriction of imports of coal and coke, then the Belgian government would have the right to restrict imports of coal and coke across the Belgian-Luxembourg frontier. Otherwise coal and coke which was freely imported into Luxembourg could then have been freely transferred into Belgian territory. In fact in the late 1930's Belgium did impose restrictions on coal and coke imports separately from Luxembourg and

* The above account of the steel problem is based upon Majerus, *op.cit.*, pp. 49-55; and Hommel, *op.cit.*, pp. 87-92.

Belgians were in fact prevented from importing coal freely from Luxembourg.

One final measure of support to the Luxembourg steel industry is worth mentioning. In early concessions made by the State to private operators for the mining of Luxembourg iron-ore a clause had always been included which prevented the export of the ore, thus giving a special advantage to the Luxembourg iron and steel industry which used the ore over foreign (including Belgian) users of the ore. During the period under review these clauses continued to operate in a number of the concessions and thus constituted an exception to the principle of equal trading opportunities for Belgians and Luxembourgers throughout the area of the Union. But this derogation from the free-trade principle was in fact of only limited importance for a number of reasons. First, the clause did not cover all iron-ore production in Luxembourg so that there were considerable marginal supplies which could be freely traded. Second, Luxembourg ore is of very low iron content and, because of transport costs, is therefore less likely to be transported far for further use. Third, with the great development of the Luxembourg steel industry Luxembourg had in the inter-war period in fact become an importer rather than an exporter of ore. By tonnage she covered 37 per cent of the total ore requirements of her steel industry by imports in 1925; this percentage had risen to 63 per cent by 1938; and by iron content these percentages would be considerably higher.*

XII. THE LUXEMBOURG RAILWAYS

We have dealt above with four cases—agriculture, wines, alcohol, and iron and steel—in which special provisions were needed to protect special interests. There is another general type of problem which sometimes occurs in the formation of economic unions, namely, the control of large public utilities whose pricing or other policies can intimately affect competition within the Union. Transport systems are often an outstanding example of this; and in the case of the Belgium-Luxembourg Economic Union the Luxembourg railways presented an interesting case in point.

The history of the Luxembourg railways after the formation of the Belgium-Luxembourg Economic Union was an extremely complicated one. Much of it is not very strictly relevant to this study, and for this reason it will be considered only very briefly here.† At the time of the

* See Hemmer, *op.cit.* Première Partie, pp. 84-85 and Deuxième Partie, pp. 36-41.

† Fuller accounts are to be found in Majerus, *op.cit.*, pp. 95-100; Majerus, *Les Chemins de Fer à Section Normale du Grand-Duché de Luxembourg*. Luxembourg. 1933;

formation of the economic union with Belgium there were two railway networks in Luxembourg: the Guillaume-Luxembourg system and the Prince Henri system. These were of approximately the same length, but the traffic on the Guillaume-Luxembourg, which provided the principal North-South and East-West routes through the country, was twice as important as that on the Prince Henri. Both systems were Luxembourg concessionary companies; but whereas the Prince Henri company had not only built but also was operating its own system, the Guillaume-Luxembourg company had built its system but had rented it out for operation to the German Alsace-Lorraine railway system in 1902 when Luxembourg formed part of the German Zollverein.

At the end of the first world war the Guillaume-Luxembourg railway system was in fact being operated by the French as part of the military measures necessary for the allied armies. The Guillaume-Luxembourg railway was operated by the French Alsace-Lorraine railway system, which paid the rent due to the Guillaume-Luxembourg company from the German railways under the convention of 1902 whereby the system had been leased for operation to the German railways.*

When the Belgium-Luxembourg Economic Union was formed Luxembourg was faced with a twofold task: the unification of her two systems—the Guillaume-Luxembourg network and the Prince Henri network—into a single system and the linking of that system with the Belgian system in order to ensure uniform conditions of transport throughout the Union.

The provisions of the treaty of economic union foresaw developments on these lines. The essential idea in these provisions of the treaty was that either the Belgian State alone or the Belgian and Luxembourg States jointly or some organisation jointly agreed by the two governments (such as the Prince Henri railway company itself) should take over and unify the two Luxembourg systems and operate them closely in conjunction with the Belgian railway system.

In preparation for a solution on these lines the Luxembourg government on 25th June 1921 reached an agreement with the Guillaume-Luxembourg company, whereby the Luxembourg government obtained the right to arrange for the leasing of the Guillaume-Luxembourg rail-

Hommel, *op.cit.*, pp. 130-141; and Treinen, *op.cit.*, pp. 91-99, on which the brief account in this study is based.

* Under this convention Germany undertook not to use the Guillaume-Luxembourg system for the transport of troops or war materials. It was on the grounds of the breaking of this obligation in the war of 1914-18 that the Luxembourg government terminated the German right of exploitation.

way system to any operating company which the contemplated railway re-organisation might require.*

The contemplated solution was, however, doomed to failure. On 15th May 1925 the Luxembourg government signed agreements both with the Prince Henri company and with the Belgian government, which contemplated the following arrangements. The Prince Henri company would have been the chosen organisation for the operation of the Luxembourg railway system; the Belgian and Luxembourg governments would have guaranteed bonds to be issued to raise the funds necessary to take over rolling stock from the Alsace-Lorraine railways and for similar purposes, and they would have shared on an equal basis in a special fund to be provided for the running of the railway by the Prince Henri company; a *Conseil Supérieur des Chemins de Fer* and a *Comité Administratif* (on the lines of the organs of the Economic Union itself) would have been set up to decide upon problems other than the daily running of the railways (e.g. upon the financial regime, the rates to be charged, new capital works, and so on). In both these organs Luxembourg would have had the predominant voice, except on certain matters (e.g. on charges for carriage to the port of Antwerp) which vitally affected Belgian interests. The daily operation of the railway system would, however, have been in the hands of the Prince Henri company which, though a company registered in Luxembourg, had under its statutes a majority of Belgian directors. This settlement was rejected by the Luxembourg parliament in January 1925, objection being taken to the fact that the Prince Henri company (the proposed operating company) was under Belgian control, to the fact that the rent which would have been received under the convention by the Luxembourg State for the concession of the railway system was low, and to the fact that the convention reserved to the French the right of running whole trains on the Luxembourg system made up of French material and run by French personnel.

As a result, in the course of 1925 a *modus vivendi*, subsequently modified in 1927 in certain respects, was arranged between the Luxembourg

* The Guillaume-Luxembourg railway system had, under the convention of 1902, been leased for operation to the German railways for an annual rent of 3,866,400 *gold francs*. In the agreement of 25th June 1921 between the Luxembourg government and the Guillaume-Luxembourg company it was stated that the Luxembourg government would pay an annual rent of 3,866,400 *francs* (i.e. Belgian or Luxembourg francs) as soon as the system ceased to be operated by the Alsace-Lorraine railway administration. After the breakdown of the negotiations discussed in the next paragraph this discrepancy in the denomination of the francs in which the rent was payable led to protracted litigation involving the Luxembourg government, the Alsace-Lorraine railway administration, and the Guillaume-Luxembourg company.

government and the French Alsace-Lorraine railway system, whereby the latter continued to operate the Guillaume-Luxembourg system;* this arrangement could be denounced at six months' notice on either side, but in fact the operation of the Luxembourg railways continued on this basis until the outbreak of the second world war.

The *modus vivendi* of 1925, as modified in 1927, contained the following provisions. Except for tariffs for transit traffic, traffic in Luxembourg was to enjoy the lowest rates applicable in Alsace-Lorraine to similar traffic; and, as for transit traffic in Luxembourg, the administration of the Alsace-Lorraine railways undertook generally to take measures to promote it. The Luxembourg government reserved the right to apply still lower rates in Luxembourg, but if it did so it had to make good the revenue thus lost to the Alsace-Lorraine railway system.

A complication arose from the fact that the Luxembourg government had passed a railway Statute which ensured different, and at the time considerably better, conditions of work and pay to the Luxembourg railway workers than those granted under French arrangements to the railway workers on the rest of the Alsace-Lorraine system. It was accordingly agreed that the Alsace-Lorraine administration should provide the Luxembourg rates of pay and other conditions on the Guillaume-Luxembourg railway system; that if this involved a saving for the Alsace-Lorraine administration it would pay a corresponding sum to the Luxembourg treasury; but that if, as was in fact the case, it involved additional expenditure this would be reimbursed by the Luxembourg government to the Alsace-Lorraine administration. To raise the revenue necessary for this purpose the Luxembourg government could impose surcharges on railway traffic within Luxembourg. There were considerable complaints by Luxembourg traders against the addition to their transport costs which these surcharges involved; and the surcharges were in fact abolished in May 1932 by which date the fall in the cost of

*Under this arrangement the rent payable by the Alsace-Lorraine system to the Luxembourg government (as distinct from the rent of 3,866,400 francs payable to the Guillaume-Luxembourg company) was raised to 1,000,000 francs a year from the 250,000 francs a year originally payable to the Luxembourg government under the convention of 1902 when the Guillaume-Luxembourg system was handed over to German operation. But in 1927 the Luxembourg government agreed to change this fixed rent of 1,000,000 francs into a share of the profit and loss made by the Alsace-Lorraine administration on the Guillaume-Luxembourg system; and thus, after enjoying considerable profits in 1927, 1928, and 1929, it was involved in still more considerable losses in 1930, 1931, 1932, and 1933 with the onset of the great depression. In 1934 the *modus vivendi* between the Luxembourg government and the Alsace-Lorraine administration was once more altered so that the Luxembourg government no longer shared in either the profits or the losses of the Guillaume-Luxembourg system.

living in Luxembourg, to which railway wage-rates were adjusted, had caused remuneration of railway workers under the Luxembourg railway Statute no longer to exceed the remuneration of the Alsace-Lorraine railway workers.

The administration of the Alsace-Lorraine railways had the right to impose a surcharge of 1 per cent on traffic on the Luxembourg part of its system, to counterbalance the fact that a duty of this height was payable on all traffic on the French section of the Alsace-Lorraine railway system, as part of the general French turnover or sales tax; and this surcharge could be raised or lowered in correspondence with any subsequent rise or fall in the French turnover tax. The receipts from this surcharge represented, of course, a net revenue to the Alsace-Lorraine railway administration, since it was not payable as a tax to the French government; but the Alsace-Lorraine railway administration agreed to use the proceeds towards the finance of the application to the Luxembourg railway workers of the more expensive Luxembourg railway Statute.

In effect, therefore, throughout the period under consideration that part of the Luxembourg railway system which was important for more than local traffic was run as a part of the French Alsace-Lorraine railway system. This meant that railway traffic between Belgium and Luxembourg passed from one to another railway system at the frontier; and this in turn meant that there was a break in the system of tapering railway rates at this point. Traffic was charged on the Belgian stretch a rate which was lower, the longer the distance covered in Belgium. It was then charged again on the Luxembourg stretch a new rate which was lower, the longer the distance covered in Luxembourg. The traffic did not get the advantage of a rate which was reduced according to the total distance covered in Belgium and Luxembourg. But traffic between Luxembourg and Alsace-Lorraine moved on what was treated as a single system and thus got the advantage of a rate the reduction in which was calculated on the whole stretch covered in France and Luxembourg together.* To some extent, therefore, the railway system may have favoured Luxembourg trade with France rather than with her partner Belgium. But distances in Luxembourg are in fact so small that this consideration cannot have been of very major importance. On the other

* The fact that the Prince Henri railway system was run separately from the Guillaume-Luxembourg system meant that there was also a similar break in the tapering railway rates when traffic moved between these two Luxembourg systems, just as there was a break when the traffic moved between the Guillaume-Luxembourg system and the Belgian or German systems. Unification of rates within Luxembourg itself was one of the reasons why a unification of the Prince Henri and the Guillaume-Luxembourg systems was desired.

hand, it should be remembered that the main trade of Luxembourg was in products like coal, iron-ore, and steel on which costs of transport are high and that Luxembourg had no important alternative systems, such as waterways, for their transport. As the French railway tariff on such products started with a high rate which quickly tapered off, there was a marked difference between the rates payable for those journeys which did, and those which did not, involve a transfer of the traffic between the Guillaume-Luxembourg-Alsace-Lorraine network and other railway systems.

XIII. CONCLUSION

Can we learn any general lessons for the building of economic unions now or in the future from this history of the working of the Belgium-Luxembourg Economic Union in the inter-war years? It would, of course, be absurd to attempt to generalise from one single instance; but there are some broad ideas which this story may suggest.

The building of the Belgium-Luxembourg Economic Union did not have to overcome two sets of basic problems which may be expected to confront most important economic unions.

In the first place, it was a union between a relatively large and a relatively small partner. This meant that many questions which would otherwise have required difficult negotiations were quickly solved, either because the small partner merely took over the existing arrangements of the predominant partner (for example, the rates of the Belgian customs and excise duties were applied unchanged to Luxembourg trade) or else because a concession which was vital for political or social reasons for the smaller partner would cause an insignificant hurt to the much larger economy of the predominant partner.

Secondly, monetary history and pre-existing monetary institutions made it natural that a single currency (the Belgian franc) should in fact form the main monetary circulation throughout the Union. This meant that Luxembourg could not have a separate domestic financial policy controlling the degree of monetary inflation or deflation within her economy; the level of the monetary circulation and so of money incomes, prices, and costs in Luxembourg depended upon the financial policy of Belgium. It also meant that there was no technical problem in making payments between the residents of the two countries forming the Union.

It is perhaps difficult to exaggerate the importance of these two considerations in easing the building of an effective union. Together they account for the greater part of the difficulties which have confronted,

for example, the building of Benelux since the second world war. But there are at least four important remaining sets of problems which are well illustrated by the experience of the Belgium-Luxembourg Economic Union.

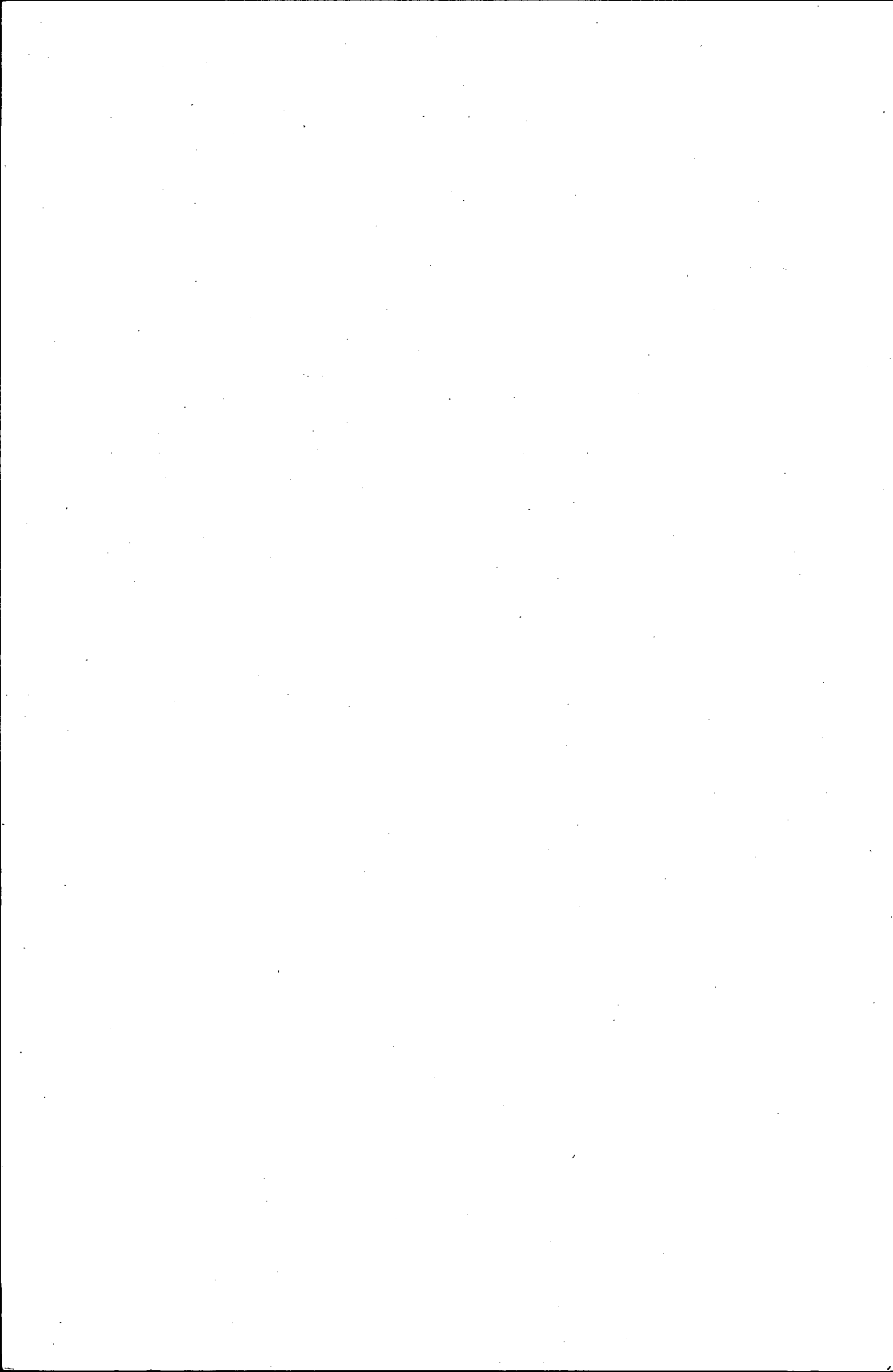
First, the fact that there was no balance-of-payments problem within the Union did not mean that there was no balance-of-payments problem of the Union as a whole with the outside world. When in the 1930's restrictions were imposed on imports into the Union from the outside world partly as a means of controlling payments to the outside world, it became clear that *either* these controls must be imposed as a single joint programme for the Union as a whole *or else* if each partner country was to operate its own national licensing system trade across the common frontier would also have to be controlled, in order to prevent the flow of goods into the partner with strict restrictions on imports from third countries *via* the partner with lax restrictions on imports from third countries. In the Belgium-Luxembourg Economic Union in the 1930's the former solution (which is, of course, the only solution compatible with the maintenance of a true union) was for the most part tried; but it involved the setting up of a compact joint organisation to determine the degree of restriction for the various products and the distribution of the import licences between the claimants in the two countries.

Second, the removal of all controls over trade at the common frontier would have involved not only the institution of a common customs tariff on imports from third countries but also a unification of the rates of duty and of systems of taxation for the domestic excise duties and turnover taxes of both countries. This, however, has implications for the budgetary revenues of the partner countries; it would mean that neither country could raise or lower its national budgetary revenue from the whole range of indirect taxation to fit in with its own national policies of State expenditure without persuading or compelling a similar change in the revenue of its partner's budget. One of the main reasons why it proved impossible to unify the turnover taxes of the two countries was the budgetary implications of any reduction in the Belgian rate of duty; and the failure to unify these taxes meant that offsetting import charges had to continue to be made on products liable to turnover tax when they were imported by one partner from the other.

Third, the Belgium-Luxembourg Economic Union is—quite rightly—generally regarded as an example of a really effective economic union. But it is interesting to observe that even in this case it was necessary to make a number of special provisions to meet the real or imagined political, social, or economic needs of special sectors of the economies

concerned. The most notable of these were the exceptions made for the protection of Luxembourg against Belgian agriculture; any economic union would indeed itself be an exception if it did not include an exception for agriculture. An illustration of other particular problems of less basic importance is provided by the special treatment necessary for the alcohol duties, for wines, and for the transport of steel in the Belgium-Luxembourg Economic Union.

Fourth, it is clear that it was the administrative organs involving regular and frequent consultation between the officials and Ministers of the two governments concerned which in fact led to the successful working and development of this economic union between two sovereign states. Those organs (such as the ambitiously conceived general Council which was to advise the governments on the working of the union and the arbitral body to settle disputes between the governments) which were 'external' to the two governments themselves never worked effectively. It may not be safe to generalise from this; but there can be no doubt that in this particular case the union worked because of regular and well-organised inter-governmental discussion and negotiation of problems as they arose.



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