

ESSAYS IN INTERNATIONAL FINANCE

No. 25, March 1956

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THE BELGIUM-LUXEMBOURG  
ECONOMIC UNION,  
1921-1939

*Lessons from an Early Experiment*

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JAMES E. MEADE



INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS AND SOCIOLOGY

PRINCETON UNIVERSITY

Princeton, New Jersey

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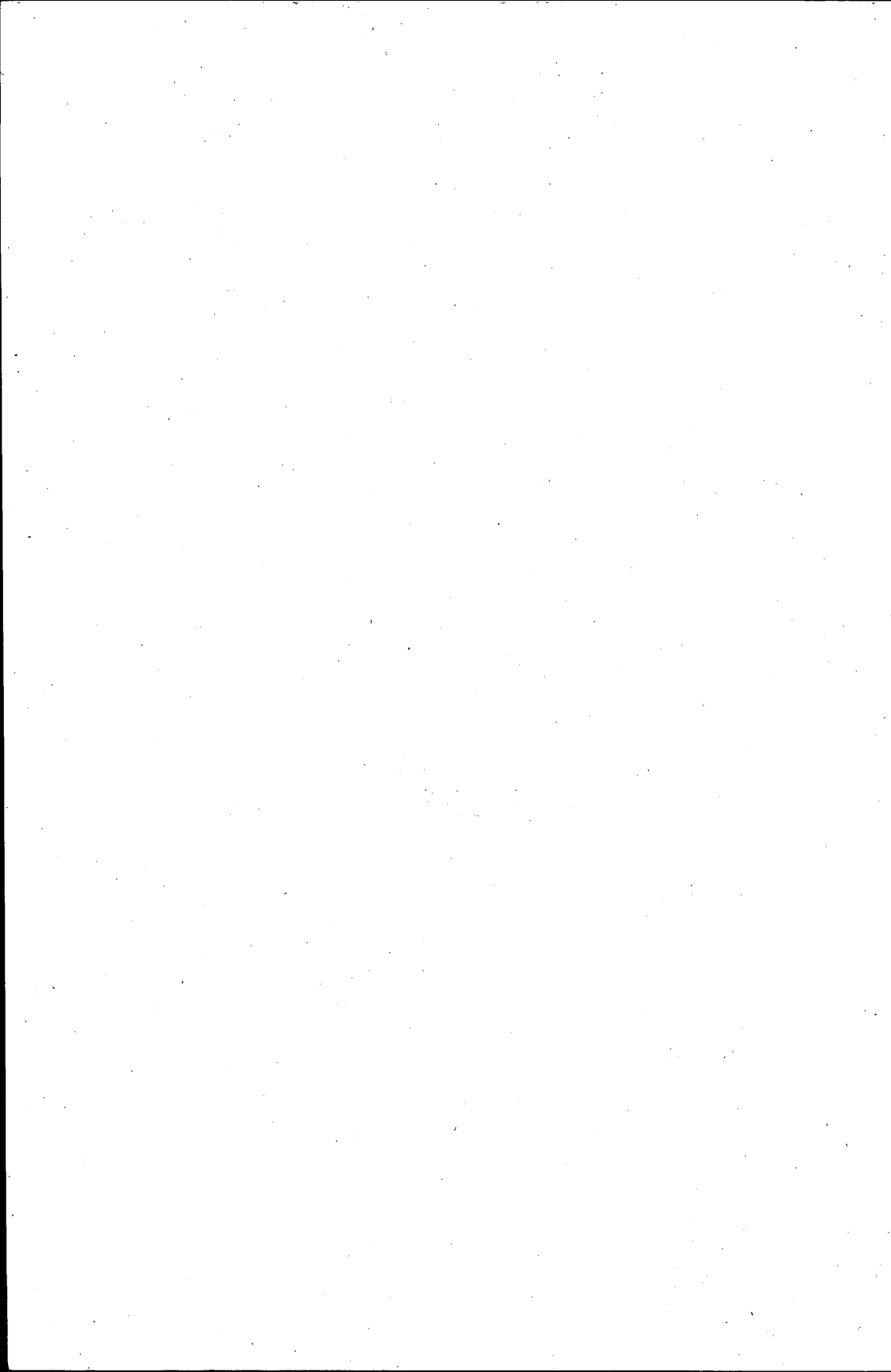


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# THE BELGIUM-LUXEMBOURG ECONOMIC UNION, 1921-1939\*

## LESSONS FROM AN EARLY EXPERIMENT

### I. INTRODUCTION

**T**HIS 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 Wirtschaftsbündnis 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

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*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