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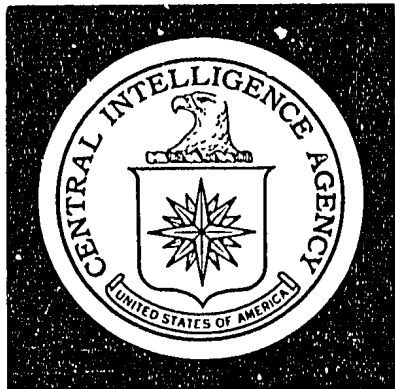
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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The European Communities: A New Phase

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2 March 1970
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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
2 March 1970

INTELLIGENCE MEMORANDUM

The European Communities: A New Phase

The transition period of the European Economic Community (EEC) ended on 1 January in an atmosphere of renewed confidence that the European Communities (EC)* are again moving forward. Like so many of the 12 transitional years, however, the final one was marked both by crisis and by progress. The grave problems of the common agricultural policy and the parity changes effected unilaterally by France and Germany for a time threatened to disrupt the community before it reached the "definitive" stage. On the other hand, the summit meeting of the six members in December--successful in large part because of the emergence of new governments in Paris and Bonn--produced a so-called "spirit of The Hague" that led to salubrious decisions before the end of the year. A certain fragility in this spirit became apparent early in 1970 when the financing agreement almost came undone, but the members again worked out the compromises necessary to maintain the momentum.

**The other components of the Communities are the European Atomic Energy Community (EURATOM) and the European Coal-Steel Community (ECSC).*

NOTE: This memorandum was produced solely by CIA. It was prepared by the Office of Current Intelligence and coordinated with the Office of Economic Research, the Office of Strategic Research, and the Office of National Estimates.

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What sort of economic community has emerged from the transition period and how its internal structure is developing will greatly affect the future organization of Europe. This memorandum examines the EC as it now is--its institutions and programs--and discusses the various political and economic events that will shape it in the months ahead. The important developments and decisions that accompanied the end of the transition period and their impact on the EC are emphasized. Primary conclusions are found in paragraphs 31-37.*



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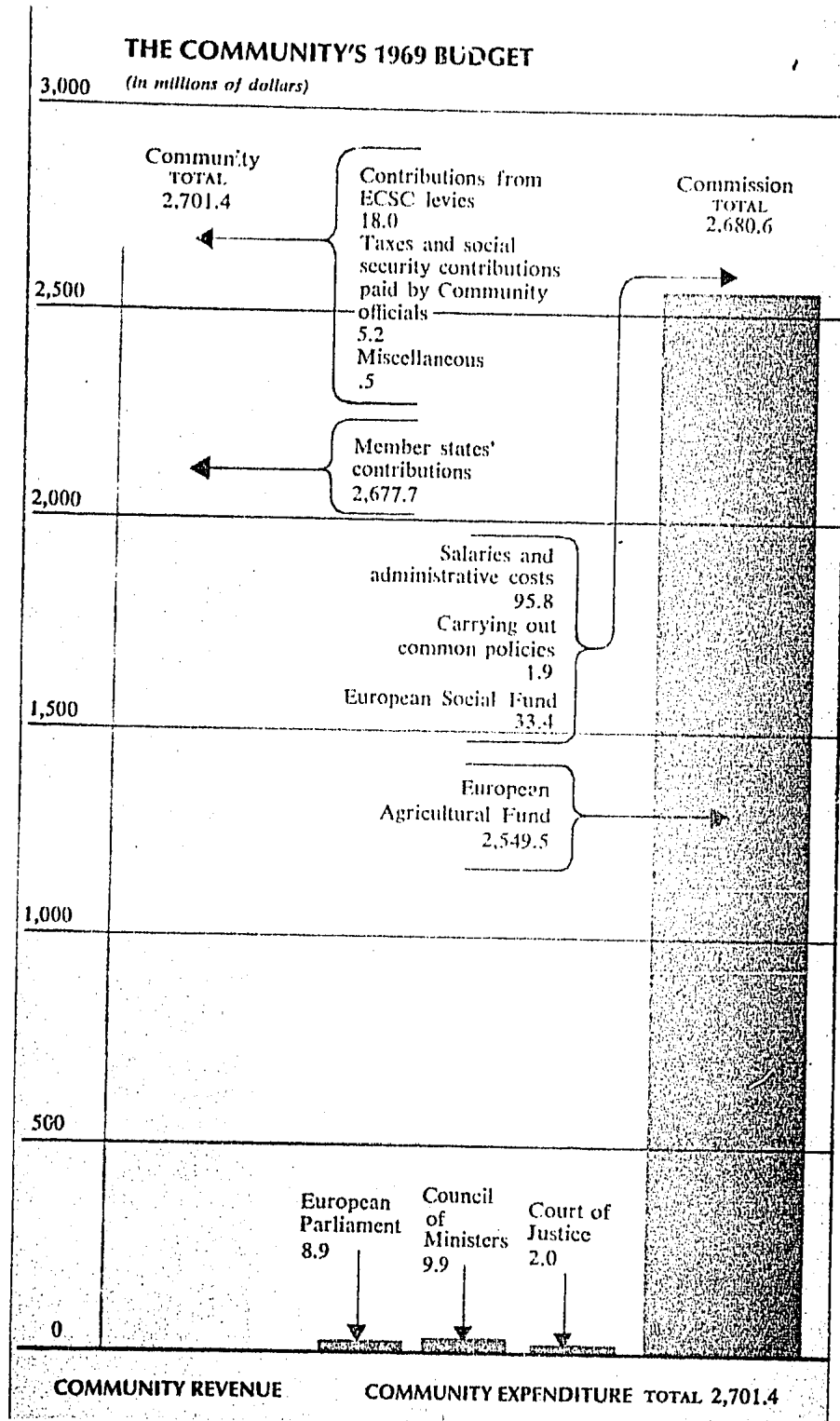
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1. The movement of the EEC from its transitional to its definitive stage is in itself a landmark in the development of the European Communities. Under the terms of the Rome treaties, the members were committed to establish during this 12-year period a "common market." The treaties also provided, however, that the period could be extended for an additional three years, and in the fall of 1969 it appeared that the EEC might have to take advantage of this provision. An agreement on how to finance the Communities did not seem near, and certain treaty deadlines could not be met. The Commission, the EC's executive body, nevertheless decided not to propose an extension, and the members went on to reach agreement on financing, a stipulation laid down by the French for their approval of entry into the definitive stage. Although some treaty commitments, such as the removal of restrictions on the right of entrepreneurs to establish businesses and to supply services throughout the community, were not met, the Commission hopes to close these gaps during 1970.

2. These few legal shortcomings do not seriously detract from the many accomplishments of the transition period. The member states have eliminated customs duties and most quantitative restrictions among themselves and have established a common customs tariff for third countries. Workers are free to move throughout the market area and have equal access to jobs in all six countries. The common agricultural policy has been established for most products; the principle of community financial responsibility for the policy has been accepted. The members have also gradually applied a common policy on competition, and all but Italy and Belgium have adopted the value-added type of turnover taxation prescribed by the Communities. Italy and Belgium were granted exceptions and will have to institute the tax by 1975. In sum, many of the obstacles to the effective operation of a community-wide market have been removed, and a solid base has been created for movement toward full economic union.

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Financing the Communities

3. By far the most important event in the internal development of the EC last year was the agreement reached on how to finance the Communities in the 1970s. The EC is now financed by contributions from member states and receipts from levies on agricultural imports. But under the new agreement, concluded in principle during a marathon negotiating session in December and confirmed in a similar session ending on 7 February, the Communities will acquire their own sources of financing and will no longer be dependent on direct national budgetary contributions.

4. The plan will be implemented in two transitional stages, the first running from January 1971 through 1974 and the second from January 1975 through 1977. In the first stage, the EC will still receive all agricultural levies, but added to these funds will be a portion of the customs duties assessed on non-agricultural goods entering the EC from the outside. Each year, the percentage of customs duties allocated to the EC will increase. The difference between the sum total of agricultural levies and customs duties and the EC's budgetary needs will continue to be made up by national contributions. Year-to-year variations in the share of the total cost burden borne by each of the member countries will be limited to a narrow range.

5. From January 1975 on, the EC's own resources will include all the agricultural levies and all the receipts from the common external tariff. Added to this will be a portion (up to one percentage point) of the value-added tax collected by the member countries. Fluctuations in the relative contribution of any member will remain controlled only until January 1978. From then on, the EC will receive all levies, tariffs, and their portion of the value added tax.

6. By gaining access to ensured sources of revenue, the communities have been materially strengthened. Unofficial estimates suggest that these sources could bring in as much as \$8 billion a year by 1978. These large independent financial

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resources no doubt have potentially important political significance, but whether they contribute significantly to the movement toward a more politically centralized union depends on the decisions made by the members on the future role of the EC's institutions. The limited budgetary role given the European Parliament in the new financing agreement is a reminder that the member states ready to accept the political implications of economic union still do not find it easy to move those that do not.

Budgetary Powers for the European Parliament

7. Because the budgetary resources of the EC will in large part be free of national parliamentary control by 1975, the Commission and some of the member states have long felt that the final budgetary control in the Communities should ultimately be vested in the most representative of its institutions, the European Parliament. The Commission therefore placed before the EC Council of Ministers in 1969 a proposal that in due course would give budgetary responsibility to the Parliament. A revised version, adjusted on numerous occasions to satisfy the objections of either the member states or the parliamentarians, was accepted by the Council in December. In January, however, the French Government--in response to pressure from such ultra-Gaullists as Defense Minister Debre--made it clear that it would insist on modifying the December accord. Because none of the other members was prepared seriously to jeopardize the renewed forward movement within the community and the prospective negotiations with Britain, a compromise solution was reached on February 7.

8. Ever since the Communities were created, the Parliament's role in the budgetary process has been an advisory one. It receives an "established" budget from the Council. If the parliamentarians desire, they may submit budget amendments to the Council for consideration, but the Council is free to ignore their recommendations, and it does not have to explain its action to the Parliament.

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9. Under the new arrangement, Parliament will be given somewhat greater authority during the interim period 1971 through 1974. Final control of the entire budget will remain with the Council, but the Council will no longer be able to ignore Parliament's amendments. If the Parliament amends the budget so as to increase expenditures, the Council must approve the amendments by a qualified majority vote* before they will take effect. If no increase in over-all expenditures are involved, the amendments will be considered approved unless the Council overrides them by a qualified majority vote.

10. Beginning in 1975, the Parliament will have the final control over that portion of the budget covering the administrative expenditures of the Communities, currently about three percent. The Parliament, however, will not be able to increase these expenditures beyond a point that will be fixed by the Commission according to a complex formula based on increases in gross national product, national budgets, and the cost of living. On the rest of the budget (currently about 97 percent, most of which goes to agriculture), the Council will still be able to reject any parliamentary amendments. But the fact that the Council will have to muster a qualified majority to do this will permit the Parliament to influence even this part of the budget. Additionally, the Council has agreed formally to present to the Parliament its reasons for rejecting any particular amendment--some advance over the past, when the Council refused to engage in any such dialogue.

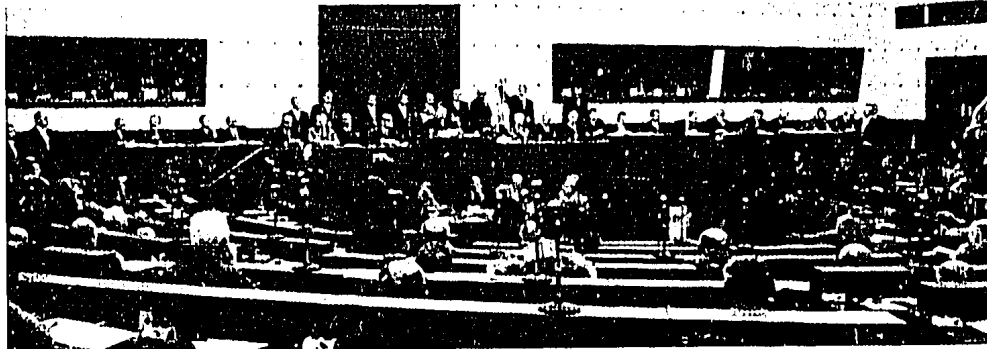
**In qualified majority voting, current arrangements provide four votes each for France, Germany, and Italy, two each for Belgium and the Netherlands, and one for Luxembourg. A total of 12 votes constitutes a majority; thus no state holds a veto.*

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The European Parliament in Session, Strasbourg, France

11. The budgetary powers agreed to are certainly far short of what the Parliament would have liked, and continued discontent can be expected from the parliamentarians. But the role of the Parliament may become somewhat greater in practice than would be indicated by the small portion of the budget that it will control. Administrative responsibilities of the Communities will probably increase in the years to come, especially if the Six become Ten. The importance of Parliament's control over funds for these administrative functions will therefore increase as well. In addition, through its control over funds for information activities the Parliament could influence attitudes toward the EC among European peoples and governments. Most importantly, the Parliament will have its first truly supranational powers.

Planning for the Future

12. In spite of the importance of the achievements during the transitional stage, development of a true economic union is far from complete. Many Europeans look upon the opening of the definitive period as another beginning for the organization. In addition to fulfilling the specific treaty requirements that were not met on schedule, policies agreed to must now be applied, many new policies must be adopted, and community institutions must be further developed in order to attain a full economic union.

13. Commission President Rey recently set forth what he sees as the tasks for the EC in 1970: the

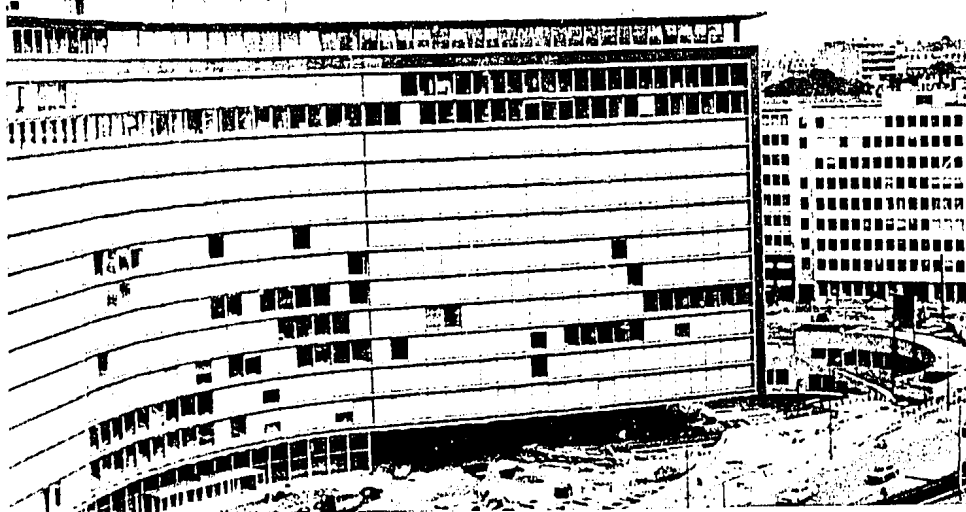
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adoption of the Barre Plan for closer coordination of monetary and other economic policies and the preparations to move beyond it; reform of the structure of agriculture (Mansholt Plan); new impetus for research and technological programs; new guidelines for the EC's industrial policy; development of a common energy policy; reform of the European Social Fund; and implementation of the regional policy. In addition to the program listed by Rey, the application of the common commercial policy, formulated late last year, will be important in 1970.



The European Communities New Administrative Center, Brussels

Coordination of Monetary Policies

14. The outlook for some parts of Rey's agenda is comparatively bright. Closer monetary cooperation among the EC members has long been recognized by community experts as an essential step toward the achievement of economic union. In recent years, particularly in 1969, the national governments too have begun to realize that the need to strengthen these ties may override more nationalistic considerations. The devaluation of the franc in August and the revaluation of the German mark in October, with their disruptive impact on the common agricultural market, helped to further this view. The increased volume of commerce across the six national

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boundaries, reflecting the growing interdependence of the six economies, has made increased coordination of economic policy a more urgent necessity. Moreover, the development of common policies (e.g., free internal trade, common external tariff) has reduced each member's ability to deal with its economic problems and thus has made each country more dependent upon the cooperation of the other members.

15. At The Hague summit meeting, the leaders of the member countries expressed their intention finally to take the steps that the Commission had been urging for some time, and pledged that "a plan to be carried out in phases shall be developed during the course of 1970 with the purpose of realizing an economic and monetary union." The first phase will be based on the Barre Plan, which the Commission presented to the Council early in 1969. If applied fully in the 1971-1975 period, the plan would lay the groundwork for still more extensive measures later on.

16. Under the Barre proposals, named for Commissioner Barre, the member states would coordinate their short- and medium-term economic policies. If a member state wished to follow a course differing from the common aims or seriously affecting economic developments in other member states, it would be required to consult with the other members in the appropriate EC forums before taking action. The plan also calls for establishment of mechanisms for short- and medium-term monetary assistance. Late in January 1970, the Council accepted the short-term consultation provisions and established a fund with member-state credits--initially of \$1 billion but eventually of \$2 billion--on which the members will be able to draw in times of balance-of-payments difficulties.

17. At the same January meeting, the Council postponed decision on the medium-term credit plan on the grounds that further work on harmonization of medium-term economic policies would be necessary. This plan, however, is scheduled for further discussion this year, after the EC members have agreed on medium-term economic goals.

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18. It seems likely that the members, recognizing the extent to which their national interests are linked to a stable community, will continue to seek greater coordination of economic policy. Toward the end of February, the Commission and the governments of Germany, Belgium, and Luxembourg presented formulas for proceeding to monetary union, and the six finance ministers agreed to set 1980 as the target date for establishment of a common currency within the EC. The ministers set up a committee to study the various proposals. The Commission is now producing a paper on the possible pooling of the member states' special drawing rights in the International Monetary Fund, a proposal made earlier by President Pompidou. In addition, EC central bankers are working on the eventual creation of a European central reserve facility. The countries that traditionally have had balance-of-payments surpluses, particularly Germany, will press for close coordination of over-all economic policy before moving on to further monetary integration. There is among the members real motivation to move toward a full economic union, but because of the far-reaching implications progress is likely to be slow.

Common Agricultural Policy

19. Reform of the common agricultural policy the costs of which have skyrocketed, remains the EC's most pressing problem. For over a year, the Six have had before them the ambitious long-range approach to agricultural reform proposed by Commissioner Mansholt. The members, however, generally believed that the structural reforms envisioned in his plan would be too expensive and too sensitive politically. A modified, less ambitious version proposed by the Commission late last year has so far also failed to make any progress.

20. Current prospects are that any broad attack on the structural problems of community agriculture will be deferred at least until 1973. As part of the recent financing agreement, the members decided to maintain an upper limit of \$285 million a year on EC-financed expenditures for this purpose until 1973,

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when the ceiling may be upped by a weighted majority vote of the Council. Meanwhile, European farm organizations have tried to convince the Six that the surplus problem is not really as bad as the Commission has insisted and are digging in their heels against any policy revisions. In France, the conservative farm groups resist any measures that would eventually move large numbers of farmers out of agricultural production into other sectors of the economy. In Germany, farmers strongly oppose reductions in price support levels, and the battle lines are already drawn within the government between the finance and foreign ministries, which favor price cuts, and the agriculture ministry, which opposes them. Some in the EC would use production controls to limit surpluses, but the French in particular oppose this and are supported by Commissioner Mansholt.

21. The complexities of the problem are staggering, and there will be numerous domestic and international repercussions no matter what approach the EC takes. Although it is possible that The Hague summit commitment to tackle the problem of curbing the increasing costs may compel the members to make at least some initial adjustments, the forthcoming negotiations with Britain seem to be a more promising source of pressure for reform.

Research and Technological Policy

22. An EC Council decision last December to extend EURATOM's research program has alleviated the chronic crisis in EURATOM and has improved prospects for cooperative European efforts in nonnuclear research and development. Early last year the Commission proposed a five-year program that would involve EURATOM in nonnuclear as well as nuclear activities. After months of discussion, however, the Six approached The Hague summit meeting still deadlocked over EURATOM's budget and the Commission's recommendations. Nevertheless, the final summit communiqué did contain a pledge to work out a new pluriannual research program.

23. The next week, the Council of Science Ministers, noting that they had been inspired by the summit meeting, in effect voted themselves another opportunity to reach

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agreement. EURATOM's 1969 research program was extended for one year with the provision that, if a long-term program is not accepted by the end of 1970, there will be an automatic additional extension for 1971. This program, the Council agreed, will cover both nuclear and nonnuclear research--a provision that will make it possible to utilize existing research facilities more fully and perhaps eventually to broaden EURATOM's base. Still unsatisfied is EURATOM's need for a long-range program; the hope is that the members can agree on one this year.

24. Last October the EC invited 11 other West European nations to join in discussions of the future of scientific and technological cooperation. The talks, which are expected to begin early in 1970, will center on the so-called Aigrain Group's proposals for potential cooperative programs in seven different sectors: data processing, telecommunications, new means of transport, oceanography, metallurgy, pollution, and meteorology. Whether the Europeans eventually decide on an institutionally integrated program in these areas or on loosely organized cooperative ventures will have an important impact on the development of European unity in general.

Industrial Policy

25. The desire of Europeans to become more competitive with advanced American industry will be an increasingly compelling force in the EC. It should motivate the EC not only to reach agreement on a non-nuclear research program for EURATOM, but also to develop new guidelines for the EC's industrial policy. A comprehensive policy would bring together regulations designed to permit European industries to realize more fully the advantages of the large common market. It would, for example, permit formation of a community-wide capital market capable of making adequate investment funds available when they are needed and would establish guidelines for foreign investment. This year, the Six will probably again attempt to formulate a community company law that would help European companies to surmount legal and related barriers to increasing company size and otherwise enhancing their competitive position relative to US industries.

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Energy Policy

26. Late in 1969, the Council approved the basic principles for a common energy policy recommended by the Commission, and the Commission is expected this year to submit--at long last--a number of proposals that could form the core of such a policy. The six countries import nearly 60 percent of the energy they consume; assurance of a dependable and cheap supply would improve both the living standards of the people and the competitive position of European industry. The crucial question is how much energy should be supplied from domestic sources, mainly high-cost coal, and how much from imported fuels, mainly oil. The development of an effective energy policy has been one of the most vexing of community issues, and to achieve a meaningful breakthrough now will require an extraordinary effort.

Social and Regional Policies

27. A social policy that both facilitates integration and ensures that its benefits are widely shared plus a regional policy narrowing the developmental gaps between regions are important elements of the EC's movement toward a full economic union. Last fall, the Council approved a much-needed social security program for migrant workers, but the operations of the community social fund must be revised to take into account the changing manpower requirements of EC industries adapting to the larger and more competitive market. In the area of regional development, the Commission has adopted and sent to the Council a plan to establish a program that would identify areas in need of assistance, provide loans, and point the way for more extensive aid that might be supported on a national basis. The proposal--the first meaningful step in this field--will be discussed by the Council this year.

Common Commercial Policy

28. The agreement on a common commercial policy reached just before the end of the transition period seems likely to have a growing impact on the EC's institutional development as well as on its commercial

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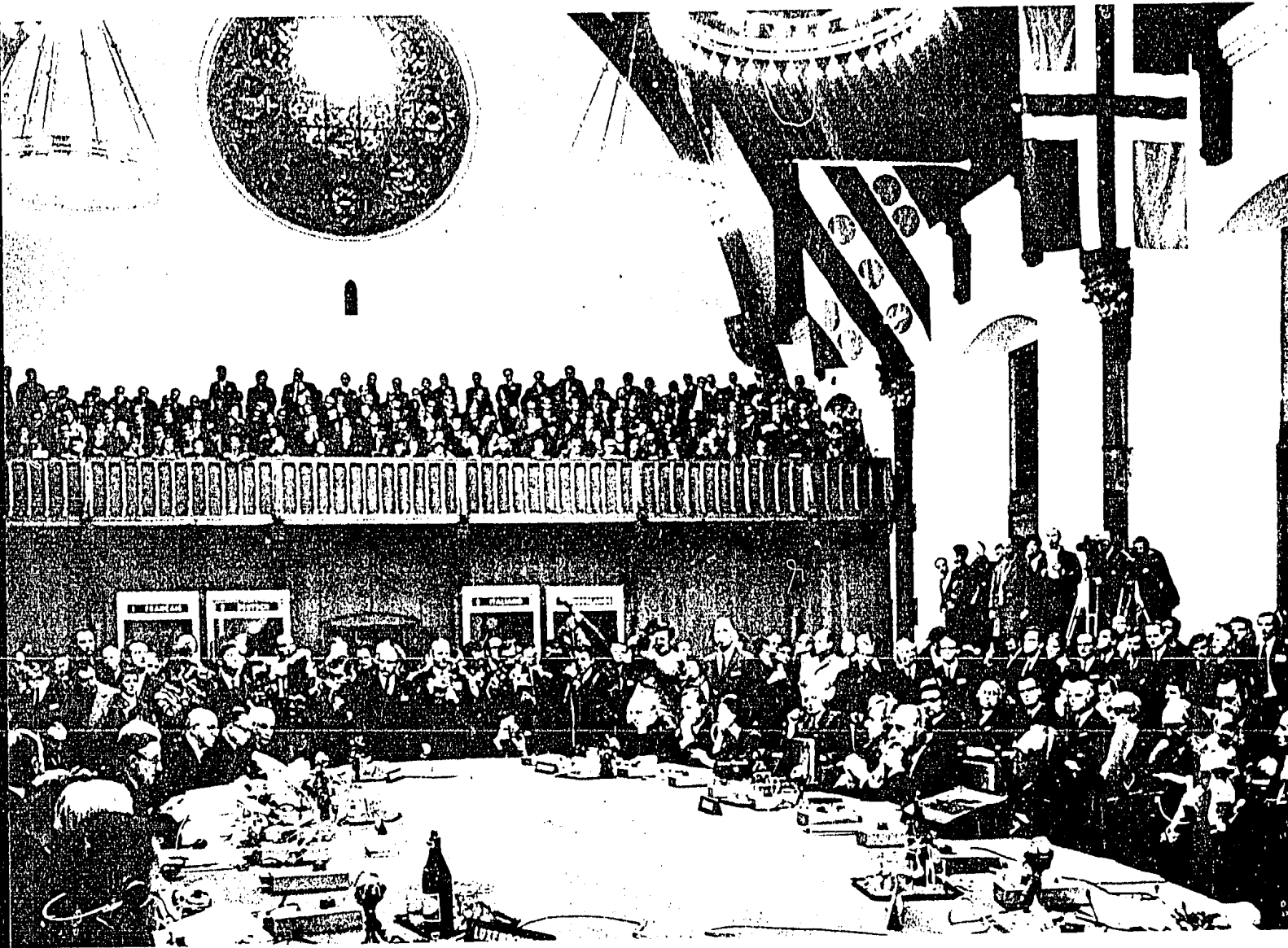
relations. Some of the consequences of the new policy are already evident. The Commission has been busy conducting trade talks with Israel and Spain, and early in February, using the negotiating authority granted it in the treaty, the Commission concluded a community trade agreement with Yugoslavia. The member states have also recently authorized the Commission to conduct the forthcoming negotiations on renewal of the long-term cotton textile agreement. In addition, the Commission is pursuing exploratory talks with Japan, and on the basis of these discussions the Council will decide whether or not to authorize the Commission to open formal trade talks with Japan.

29. In 1972, the trade relations of the member states with Eastern Europe will come more fully under community purview. Any new trade agreements with those countries subsequent to that time will have to be negotiated by the Commission, a procedure already applicable to the rest of the world. To date, only Yugoslavia among the East European countries has agreed to formal negotiations with the EC. But other East European countries, including the Soviet Union, have had informal contacts, and some of them have negotiated limited agreements. The expiration toward the middle of the decade of a number of more comprehensive trade agreements should reveal whether the member states are prepared fully to implement the common commercial policy--and whether most Communist states will still refuse to recognize the EC.

30. The special treatment the Rome treaties accorded interzonal trade between East and West Germany may become an increasingly contentious issue. The Federal Republic traditionally has designated its trade with East Germany as internal trade because a foreign trade designation would imply a de facto recognition of East Germany. The West Germans will probably wish this special status to continue, but other EC members may challenge it if the volume of trade reaches more significant levels as a result of Brandt's policies toward the East.

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The Hague Summit in the Knight's Hall, 1-2 Dec 1969

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The European Communities and Political Development

31. The end of the transition period has left the EC--despite its great accomplishments in many areas--still facing a crucial political reality: institutional development moves only as far and as fast as the members desire, and frequently no further than any single member desires. This fact has not been altered by the willingness of the six governments at The Hague summit to reach agreements that have shaken the organization from its previous lethargy and have led to concrete accomplishments. Nor is it necessarily changed by President Pompidou's relatively flexible views on European unity.

32. The coming year will test whether the EC can provide the basis for a more structured Europe. A new commission of nine members--replacing the current fourteen-member commission--must be chosen, by unanimous vote of the member states. The caliber and political orientation of the men selected, many of whom certainly will be chosen from among the present Commissioners, will at least partially determine whether the Commission will be an aggressive advocate of the EC's development. Although it is the Council that makes the final decisions in the EC, the Council acts only on the basis of Commission proposals. Moreover, the Commission is not only the initial source of EC policies; it also administers those policies once they have become programs and represents the interests of the EC both at home and abroad.

33. The Commission's authority, however, is directly tied to the effectiveness of the Council. Whether the voting arrangements in the Council that were envisaged by the Rome treaties can be restored remains a serious question. According to the treaties, once the EC had passed to the definitive stage, almost all matters should be decided by either a majority or a weighted majority vote of the Council acting on a Commission proposal. In the "Luxembourg Compromise" that ended the 1965-1966 crisis in the community institutions, De Gaulle insisted that France would not submit to any important decision with which it disagreed as his price for a return to full French participation

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in the Communities. The current French Government still maintains that the right of veto is essential on "important questions"; whether its will to use and sustain the veto will be weaker than De Gaulle's remains to be seen. Nor is it clear that other member states which have found the tacit threat of veto convenient on occasion will readily nullify the Luxembourg agreement.

34. Now that provision has been made for limited budgetary powers for the Parliament, debate on its "democratic" nature is certain to resume. Over the years, this question has been discussed in many contexts. One argument has been that if the Parliament is to have real authority, its members should be elected directly and not selected by the national parliaments. The Commission and all the member states except France subscribe to this position. De Gaulle argued that Europe is not ready for a popularly elected European Parliament, and President Pompidou apparently agrees. Chancellor Brandt and the leaders of the other member governments probably are not prepared to force the issue at this time. Although the topic was raised at The Hague meeting, the final communiqué reported only that "the problems of the method for direct elections will continue to be examined by the Council of Ministers."

35. The outlook for the future political development of the EC, therefore, remains inconclusive. The recent decisions that have moved the EC closer to a full economic union were made without any major new commitments to political unity, but their application will, in fact, result in further EC encroachments on national sovereignty. The prime examples are the provisions for the EC's independent financial resources; the limited but real budgetary powers for the European Parliament; the stronger requirements for consultation within the EC institutions prior to major member-state economic decisions; and EC management of commercial relations, including a role for the Commission in negotiating bilateral trade agreements with third countries. With the progressive growth of economic interdependence of the Six, economic policy decisions of the member states must

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increasingly be made in the EC context. It remains to be seen, however, how far these forces will carry integration and whether the member states will be prepared at some point to make the conscious decisions necessary to carry the organization from a developing economic union to a political union.

36. The six leaders at The Hague stated in their final communiqué that the ministers of foreign affairs should "study the best way of achieving progress in the matter of political unification, within the context of enlargement," and the foreign ministers were directed to report on their deliberations before the end of July 1970. Whether anything meaningful will come from these discussions is uncertain. Pompidou and Brandt both apparently believe that the time is not ripe for conclusive steps toward political unity. They apparently intend to continue the strong bilateral ties that De Gaulle so carefully fostered, and they may or may not favor proposals to generalize the Franco-German relationship into a system of intergovernmental rather than community political development. But it can be assumed that the smaller countries and the Commission will continue to argue for further building on the existing community system.

37. It is unlikely that the report from the foreign ministers will lock the EC into any particular mode of political development. It may, however, provide some further insight into a number of key questions: Do the members believe that enlargement of the communities will require stronger institutions? How flexible will Pompidou be in dealing with institutional development? How is the German attitude toward West European unity being affected by their policies toward the East? The answers will have an important bearing on the development of the EC and the role it will play in the future of Europe.

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