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CABINET**EUROPEAN FREE TRADE AREA****MEMORANDUM BY THE PAYMASTER-GENERAL**

I attach a note by officials on the implications for us of the French proposals concerning Commonwealth Preference and the Free Trade Area, to which I refer in paragraphs 14, 15 and 16 of C. (58) 65.

2. This is clearly a matter that will need the most careful handling, because the implications for our trade are very considerable. The main problem is that it would in fact suit Australia, New Zealand and possibly Canada very well to do a deal of some kind with the "Six"—France, Germany, Italy and the Benelux countries. They have been increasingly concerned at the prospect of losing their Continental markets as a result of the Treaty of Rome. Australia and New Zealand have been getting themselves into a bargaining position by obtaining the right to reduce the margin of preference they grant to the United Kingdom.

3. If it were a case of agreements between, say, Australia and the Six, in which the Six provided a better market for Australian primary products in exchange for some reduction by the Australians in the most-favoured-nation (m.f.n.) rate on industrial goods, this might in the long run be not a bad thing from our point of view. It would mean more competition for our industries in the Australian market, but the Australian market would be larger to the extent of their additional sales to the Continent. But this is not the French idea. What they have in mind is concessions by the Australians at our expense. This is a most unpleasant and dangerous idea. The trouble is that it too may appeal to the Australians and the New Zealanders, for whom a reduction in the m.f.n. rate is, in itself, a desirable thing. What prevents them reducing the m.f.n. rate at the moment is the fact that they would have to pay us compensation in some form or other. Clearly it would suit them admirably if they could say that our compensation should take the form of our access to the Free Trade Area.

4. So far as tactics are concerned, I think we should, for the moment, adopt the third course, recommended in paragraph 21 of the officials' document; but this can only be for a short time. We are obtaining as a matter of urgency the reactions of the Commonwealth Governments and we must contrive to keep in touch, as I think we can, with the progress of discussions among the Six. We must be ready to act at any turn of events, and, if my colleagues agree that for the moment we should hold our hand, I will keep them in touch with developments and seek their guidance when the time has come to take action, which may be at very short notice.

R. M.

*Office of the Paymaster-General, S.W. 1,
25th March, 1958.*

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ANNEX

IMPERIAL PREFERENCE AND FREE TRADE AREA

NOTE BY OFFICIALS

The newspaper reports of the "French plan" emphasise the importance attached to a gradual sharing by the Six (and logically all Free Trade Area members) of the United Kingdom preferences in Commonwealth markets.

2. The intention, as told by M. Faure to the Paymaster-General, is that "France should obtain in respect of a limited number of items (*e.g.*, motor-cars) a right of access to markets of at least some Commonwealth countries on terms equivalent to those enjoyed by the United Kingdom."

3. There is no intention to make concessions to facilitate Commonwealth exports to Europe. The concept would be that the United Kingdom would be granting the concession (by allowing Australia to import French cars at the British preferential tariff rate) in part payment for the Six's agreement to admit imports from the United Kingdom freely, and that Australia would have no claim for compensation by the Six, because she would not in fact be suffering any damage (to get her imports cheaper would indeed be a gain).

4. As the French conceive it, the idea could start small—say, special quotas for France for car imports into Australia and New Zealand at the British preferential rate. But the same idea would be attractive to Germany and Benelux; and the concept of a limited concession to France difficult to justify. Before very long, we should find ourselves sharing the preferences with the Six (and with the seventeen nations) over an ever-widening range of goods, and wherever there were significant preferences (Australia, New Zealand, Canada, Central African Federation). And this would lead to further pressure to generalise these concessions to the United States and Japan, and so lead to the end of Imperial Preference.

5. For Australia and New Zealand, those ideas could open interesting possibilities. In recent years (and particularly because of their fears about their future export prospects in the United Kingdom market) they have increasingly sought the European market. Australia forced the reduction of preferences in 1956 in order to get room for bargaining in Europe and elsewhere: New Zealand seeks it now likewise.

6. Since the signature and ratification of the Rome Treaty, they have been increasingly alarmed by the Six's agricultural schemes—which threaten to destroy even their present market in Europe. They have sought means of association with the Free Trade Area negotiations in an attempt to bargain with the Six. They are fighting hard in the General Agreement on Tariffs and Trade (G.A.T.T.) to retain some control over the Six.

7. The French ideas as they stand would not significantly interest Australia. They would be gaining nothing in Europe: to give a new preference to France and the Six would be in conflict with the Ottawa Agreements (reaffirmed in 1956) and contrary to G.A.T.T.

8. But it would let them in to negotiate with the Six, which is the main Australian desire. Australia might hope to gain the right to consultation (or even participation) in any "managed market" scheme for wheat, meat or dairy produce: in return reducing the preferential margins to the minimum ($7\frac{1}{2}$ per cent.— $12\frac{1}{2}$ per cent.) under the 1956 agreement with the United Kingdom.

9. This would not be what France now asks. But it would suit Germany and Belgium well. Whether they could give Australia any satisfaction in wheat, meat and dairy produce is very doubtful; we believe that part of the price of the

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Rome Treaty was a German bulk-purchase undertaking to buy French wheat. But Australia, by retaining quota restrictions on imports from the United States and Japan, could turn a reduction in m.f.n. tariff into a handsome gain for the Six, and very nearly equal treatment with the United Kingdom.

10. Australia and New Zealand may think they have much to play for; so may the Six. This would all be compatible with the Ottawa Agreements, and we could have no legitimate complaint. (Further immense complexities could arise if Australia wished to go below the preferences agreed in 1956; but this would raise political as well as economic issues). We are about to start negotiations with New Zealand on preferences in their market. These are likely to give New Zealand some freedom to reduce preferential margins, but the negotiations are not likely to be concluded for some months.

11. Canada would be less likely to be tempted by arrangements of this kind, but might well wish to follow suit if Australia looked like being successful; Canada in any case has important interests at stake in the level of the tariff of the Six on basic materials, and might be interested in negotiating on them using preferential margins as a counter.

12. The interests of the rest of the Commonwealth are smaller, both because the preferences they give are smaller and also because the possibility of using them for bargaining is less. But clearly developments on the lines indicated above would weaken the structure of Imperial Preference.

13. For the United Kingdom, much is at stake. We receive preference on about 25 per cent. of our total exports—the same proportion as our exports to Europe. Whether in the last resort we should sacrifice one in order to hold the other is a nice economic judgment. But it is contrary to the basis on which we have considered the Free Trade Area so far; to inject the preferences and to bring the "Southern Dominions" into the bargaining would create a new negotiation.

14. If this was pressed by the Six, save perhaps in respect of one or two particular items, as a fundamental condition for the negotiations to proceed, this would create an entirely new situation. The negotiation would move from being a United Kingdom/European one to one between the Commonwealth and Europe. We should first have to work out the possible courses of action, consult the Commonwealth, and then return to the Six (or not, as the case might be) in unison with the Commonwealth (or parts of it).

15. We must emphasise that all such Europe/Commonwealth schemes that we have considered since the European initiatives began in 1956 have foundered on two rocks—inevitable great damage to United Kingdom economic interests and division of interests within the Commonwealth. They might have to be considered if the straight Free Trade Area negotiations broke down. But they are not worthwhile on merits.

16. It follows that our purpose must be to stop the Six from putting forward proposals to share preferences.

17. We have considered trying to persuade Canada, Australia and New Zealand to tell the Six that such arrangements would be unacceptable. Australia and New Zealand might tell them that the French plan would be unacceptable (*i.e.*, that they were not prepared to create a new preference and would require a *quid pro quo*). But we could hardly expect them to approach the Six and bang the door on all such ideas—for, as shown earlier, they might well regard their interests as favouring this course.

18. We have considered telling the Six forthwith, formally or informally, that sharing preferences would be unacceptable in the Free Trade Area plan, and that if these proposals contained this, we should have to stop the negotiations. This would give the Six the opportunity, if they so wished, to abandon the Free Trade Area, putting the responsibility for breakdown on our attachment to the preferences and our desire to get the best of both worlds. The attitude of Australia and New Zealand might be unfavourable to this course: they already find us unsympathetic to their desire for association with the Six. Canada also might be critical of this course.

19. We should be risking both a final breakdown and a row with the Southern Dominions (after which they would probably negotiate with the Six anyway). But

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on the other hand, by acting quickly enough, we might kill the whole idea. To achieve this result, we should have to rely on fundamental arguments:—

- (i) The preferences are an integral part of the Commonwealth system;
- (ii) for the Six to propose sharing them would be contrary to the understandings on which we opened the Free Trade Area negotiations; or
- (iii) quite apart from the question of principle, the inclusion of the preferences would widen the negotiations from a European Free Trade Area to a negotiation covering Europe and the Commonwealth, and would be completely unmanageable.

20. Formal action besides being irrevocable would tend to invite the breakdown of the negotiations as well as potentially giving rise to trouble with the Commonwealth. These risks would still remain if approach was made informally, but they would be less.

21. A third course would be to wait and see. With the Six we should meanwhile take such opportunities as offer to repeat what the Paymaster-General said to M. Faure, viz., that we should not be prepared to concede our preferences as part of the Free Trade Area bargain, that they would have to bargain with Australia (not us), and that G.A.T.T. stopped them getting new preferences.

To the Commonwealth we should continue to say that, in our view, to seek to bring the preferences into the Free Trade Area negotiations would not facilitate their progress or prospects. We have already sought their reactions to the French ideas; when we have these we shall be able to consider further how far we can proceed with substantive discussion before the proposals of the Six are made.

Between now and the end of April we shall be in continual communication with the Commonwealth, but the nature of our discussions with them must depend primarily upon their first reactions to the French ideas and any further information we may be able to discover of the intentions of the Six.

March 1958.