ISSN 0379-0991

EUROPEAN ECONOMY

COMMISSION OF THE EUROPEAN COMMUNITIES
DIRECTORATE-GENERAL FOR ECONOMIC AND FINANCIAL AFFAIRS

The European Community as a world trade partner

No 52 1993

European Economy appears four times a year. It contains important reports and communications from the Commission to the Council and to the Parliament on the economic situation and developments. In addition, *European Economy* presents reports and studies on problems concerning economic policy.

Two supplements accompany the main periodical:

— Series A—'Economic trends' appears monthly except in August and describes with the aid of tables and graphs the most recent trends of industrial production, consumer prices, unemployment, the balance of trade, exchange rates, and other indicators. This supplement also presents the Commission staff's macroeconomic forecasts and Commission communications to the Council on economic policy.

— Series B—'Business and consumer survey results' gives the main results of opinion surveys of industrial chief executives (orders, stocks, production outlook, etc.) and of consumers (economic and financial situation and outlook, etc.) in the Community, and other business cycle indicators. It also appears monthly, with the exception of August.

Subscription terms are shown on the back and the addresses of the sales offices are shown on page 3 of the cover.

Unless otherwise indicated the texts are published under the responsibility of the Directorate-General for Economic and Financial Affairs of the Commission of the European Communities, rue de la Loi 200, 1049 Brussels, to which enquiries other than those related to sales and subscriptions should be addressed.

Commission of the European Communities

EUROPEAN ECONOMY

Directorate-General for Economic and Financial Affairs

1993 Number 52

The manuscript was completed in November 1992

Printed in Belgium

The European Community as a world trade partner

The second trade report

jointly prepared by

The Directorate-General for Economic and Financial Affairs and The Directorate-General for External Relations

Abbreviations and symbols used

Countries

B	Belgium
DK	Denmark
D	Germany
GR	Greece
E	Spain
F	France
IRL	Ireland
I	Italy
L	Luxembourg
NL	The Netherlands
P	Portugal
UK	United Kingdom
EUR 9	European Community excluding Greece, Spain and Portugal
EUR 10	European Community excluding Spain and Portugal
EUR 12	European Community, 12 Member States

Currencies

ECU	European currency unit
BFR	Belgian franc
DKR	Danish krone
DM	Deutschmark
DR	Greek drachma
ESC	Portuguese escudo
FF	French franc
HFL	Dutch guilder
IRL	Irish pound (punt)
LFR	Luxembourg franc
LIT	Italian lira
PTA	Spanish peseta
UKL	Pound sterling
USD	US dollar
SFR	Swiss franc
YEN	Japanese yen
CAD	Canadian dollar
ÖS	Austrian schilling
R	Russian rouble

Other abbreviations

ACP	African, Caribbean and Pacific countries having signed the Lomé Convention
ECSC	European Coal and Steel Community
EDF	European Development Fund
EIB	European Investment Bank
EMCF	European Monetary Cooperation Fund
EMS	European Monetary System
ERDF	European Regional Development Fund
Euratom	European Atomic Energy Community
Eurostat	Statistical Office of the European Communities
G-7	Group of seven major industrialized democracies (Canada, France, Germany, Italy, Japan, UK, USA)
GDP (GNP)	Gross domestic (national) product
GFCF	Gross fixed capital formation
LDCs	Less-developed countries
Mio	Million
Mrd	1 000 million
NCI	New Community Instrument
OCTs	Overseas countries and territories
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
PPS	Purchasing power standard
SMEs	Small and medium-sized enterprises
SOEC	Statistical Office of the European Communities
toe	Tonne of oil equivalent
:	Not available

Preface

This report looks at EC trade performance and policy in the 1980s. It is divided into two parts. The first has been prepared by Commission staff and covers selected issues concerning trade, integration development and growth, and the second contains expert contributions on foreign direct investment, services and intellectual property rights. The report covers developments up to November 1992.

This volume follows its predecessor 'International trade of the EC', European Economy *No 39 of March 1989. For the future, it is intended to issue an EC trade report every two years.*

This report was prepared by a joint team from the Directorates-General for Economic and Financial Affairs (DG II) and External Relations (DG I). It was coordinated by Horst Reichenbach in DG II and Michael Green, together with Pierre Defraigne, in DG I. The authors of Part One are Francisco Bataller M. (Chapter II.C), Noel Coghlan (Chapter III.B), Hans Duynhouwer (Chapter III.A), Michael Green (Chapter III.B), Françoise Moreau (Chapter III.B), Jean-Louis Koenig (Chapter III.B), Silvano Presa (Chapters I and II.B) and André Sapir (Chapter II.A and B). Technical, secretarial and editorial assistance were provided by Declan Costello, who also wrote the introduction, Alison Molders-Lawrance and Marten Van De Stadt (DG II) and Brunhilde Binder (DG I).

The authors of the second part are David Greenaway (University of Nottingham), Patrick A. Messerlin (Institut d'études politiques de Paris) and Keith Maskus (University of Colorado, USA), each presenting an independent view of new issues in international trade.

The concise overview of the EC trade policy annexed to the main report draws heavily on the reports prepared by the EC Commission and the GATT secretariat in the context of the 1991 Trade Policy Review Mechanism; it was put together by Silvano Presa.

The opinions expressed in this report do not necessarily reflect the views of the Commission.

Heinrich Matthes
Chairman of the Editorial Board
of European Economy

Contents

List of tables

List of graphs

Introduction

The rate of growth of world trade continues to outpace that of economic growth by a significant margin, implying growing economic interdependence. Consequently, trade performance and trade policy play an increasingly important role in determining economic growth and welfare. As the European Community is the leading world trader of both merchandise and commercial services and accounts for a major part of international flows of foreign direct investment, its economic influence as a world trade partner is considerable. The Community is aware of this and assumes special responsibilities *vis-à-vis* third countries. In Europe, the Community is actively encouraging and promoting the transformation of the former centrally planned economies to market-based systems. In a broader context, the Community is helping less developed economies through trade and development policies.

As a reflection of these considerations, the first part of this report is concerned with trade, integration and growth. It starts with a synopsis of Community trade in the 1980s. Thereafter, the issue of regional integration and trade is analysed, with particular emphasis on the new relationship of the EC with Central and Eastern Europe, and regional integration efforts among developing countries. The first part of this report closes with a description of the preferential regimes covering EC imports from developing countries and of their variable trade and growth performance during the 1980s.

With respect to trade policy, recent years were marked by the ongoing GATT Uruguay Round negotiations, in which the Community is a principal actor. As these talks remain to be successfully concluded, this report does not address the challenges and aspirations for a successful final result. Nevertheless, it was felt useful to provide analyses on new trade issues which are likely to increase in importance over the coming years and which have already been the subject of intense negotiations in the Uruguay Round. Consequently, the second part of this report contains expert contributions on trade and foreign direct investment, services, and trade-related intellectual property rights.

In the remainder of this introduction, a short survey of the main contents of this report is provided.

Part One on trade, integration and growth begins with a chapter which reviews the evolution of Community trade in the 1980s and notes that the EC continues to show a higher degree of trade openness than either the US or Japan. For merchandise trade, the Community has benefited from a favourable evolution in the terms of trade which has substantially enhanced real income. Throughout the 1980s, the geographic composition of Community trade has changed substantially. The increase in the share of developed countries (up from 48% in 1980 to 60% in 1990) came almost entirely at the expense of OPEC countries. Trade with Central and East European countries, although having increased in recent years, none the less still accounts for a relatively small portion of EC external trade (7% in 1990). For non-OPEC developing countries, the trends are very divergent: the declining share of EC imports coming from heavily indebted countries in Latin America and Africa contrasts with the four Asian newly industrializing economies whose import share has grown by a factor of three in the 1980s.

The market value share of Community exports in world trade has remained constant as a result of the compensating effects of an upward movement in relative export prices and a fall in market share in volume terms. A deterioration of EC price competitiveness throughout most of the 1980s appears to be only partially responsible for the slow export growth in volume terms (1,1% p.a. for the decade as a whole and 0,6% p.a. since 1986).

EFTA countries and the US are still the biggest export markets for the Community (45% in 1990). South Korea, Taiwan, Japan, Turkey, Singapore, Hong Kong, Israel, China and the US, in decreasing order, are the markets where EC exports, in value terms, have expanded the most. Manufactures represent more than 90% of total Community merchandise exports, more than half of which were accounted for by equipment goods.

The relative fall in primary product prices (particularly oil) has led to a substantial reduction in the share of such commodities in total Community imports. This, as well as other factors, resulted in an increased share for manufactures in total imports. Penetration of the EC market by foreign products has risen in most manufacturing sectors, in particular textiles and clothing, footwear and leather goods, motor vehicles and transport equipment, and non-metallic minerals. Over the last decade, Turkey, China, Taiwan, the former Yugoslavia, Japan, Thailand, South Korea, Pakistan and Austria, in this order, have experienced the biggest increases of their exports (in value terms) to the Community market. Between 1986 and 1990, the volume of EC imports rose 40,3%, much faster than EC exports. This suggests that foreign producers have been able to take advantage of the opportunities created by the completion of the 1992 single market programme.

For high-tech products, the Community has moved from an ECU 5 billion surplus in 1982 to an ECU 23 billion deficit in 1990 (a fall in the export/import ratio from 1,1 to 0,8). The limited expansion of EC exports of high-tech products

is reflected on major export markets, where EC products have progressively lost market shares largely to the advantage of products from Japan and the newly industrializing economies.

Chapter II of Part One deals with regional integration and trade, and is subdivided into three sections. It begins with an overview section of regional integration experiences in Europe (EC, EFTA and CMEA), placing particular emphasis on the evolution of the European Community. It concludes that EC integration has been successful, in that it has had a significant impact on intra-EC trade, although this may in part be explained by other factors and by the various extensions of EC membership. At the same time, EC integration has benefited world trade through its generally liberal external trade policy. The success of European integration has been followed by greater regional integration efforts elsewhere, e.g. the Europe Agreements (between the Community, CSFR,[1] Hungary and Poland) and Nafta (between Canada, Mexico and the US).

The subsequent section examines the new trade relationship between the EC and Central and East European countries (CEECs). Since 1989, the importance of EC markets for the CEECs has shot up dramatically as the previous CMEA trade regime collapsed: however, for the Community, these countries remain relatively minor partners. Whereas this geographical trade pattern of CEECs' exports is much closer to the 'normal' pattern than in the past (i.e. pre-1989), there may be some 'overshooting' given the current political and macroeconomic disturbances in the former Soviet Union. To assist in the transformation process, the Community has substantially improved the terms of access to EC markets, culminating in the signing of Association Agreements with CSFR, Hungary and Poland which aim to establish a free trade area. The Community has been prepared to act boldly by agreeing to include in the Agreements a degree of liberalization in sensitive sectors (textiles, iron and steel and agriculture), despite strong internal pressure. For textiles, there is an explicit link in the Agreements with progress in the Uruguay Round negotiations, thereby ensuring that liberalization will not be done at the expense of other trade partners. In addition, the Community is contributing to the transformation process through its own assistance programmes and the coordination of G-24 actions, including medium-term assistance to help macroeconomic stabilization.

The last section of Chapter II examines regional integration efforts among developing countries. The Community both advocates and supports such initiatives for political and economic reasons. A review of the costs and benefits for developing countries to engage in regional integration is undertaken and consideration is given to whether developing countries can draw useful insights from the integration experiences of the Community. Regional integration efforts among developing countries are reviewed, including Mercosur, Asean, the Gulf Cooperation Council and the Arab Maghreb Union. Previous integration efforts among developing countries have failed for many reasons, but especially because of limited political commitment, low levels of economic growth, the pursuit of infant industry policies, and the weakness of regional institutions. More recent integration efforts have sought to redress these weaknesses. A key condition for successful regional integration is the maintenance of an open trade regime with the rest of the world.

Part One closes with Chapter III on the trade and growth performance of developing countries in the 1980s. The first section provides an overview of the Community's preferential trading relations. The Community has extended through a number of instruments preferential, non-reciprocal trade benefits to various groups of developing countries, e.g. ACP countries and the overseas territories of the Member States, Mediterranean countries and certain Asian and Latin American countries. In addition, preferential and reciprocal trade agreements have been concluded with the EFTA countries, Central and East European countries, Turkey, Israel, Malta, Cyprus and San Marino. New arrangements are being prepared with EFTA countries, some Mediterranean countries, and with the countries of the Gulf Cooperation Council. Traditionally, preference has concentrated on preferential tariff treatment. However, with the declining importance of tariffs, other factors are increasingly determining the benefits gained from preferential trade relations: these factors include rules of origin, the treatment of non-tariff barriers, tolerance and derogation provisions, the extent of product exclusions or limitations of trade preferences, and, finally, safeguards and dispute settlement arrangements.

Despite the importance of preferential trading relations for the Community, effective trade preferences are only extended for a limited share (less than 30%) of EC imports. This underlines the importance of the multilateral trade system, which has helped to keep the potentially distorting effects of preferential trade within reasonable bounds. Trade preferences can be of assistance to developing countries, but only if they implement the necessary supporting policies which foster macroeconomic stability and the participation of the country concerned in the world economy. It appears that

[1] Prior to 31 December 1992, the Czech Republic and the Slovak Republic formed the CSFR. As most of the analysis in this text refers to the pre-1993 period, the appellation CSFR is used.

countries which experienced rapidly growing exports to the Community during the 1980s have been relatively effective utilizers of the benefits offered under the Community's generalised system of preferences.

The second section of Chapter III surveys the overall economic performance of developing countries during the 1980s. Throughout this period, growth in low and middle-income countries slowed down compared with the previous 15 years. This slowdown was, however, not uniform across all groups of developing countries, with the countries of South and East Asia registering impressive rates of growth. Export performance during the 1980s has to a large extent been the force behind economic growth. Development may be best served by an export policy mix that favours export growth based on open, undistorted markets and not by policies that promote import substitution particularly via protectionist measures. Open-market-oriented development is also likely to encourage foreign direct investment inflows. This section considers the reasons for divergent economic and export performance both within and between regional groupings of developing countries. Three regional blocs are examined in detail: the dynamic Asian economies (Malaysia, Singapore, South Korea, Taiwan, Thailand and Hong Kong), the countries of the Gulf Cooperation Council (Saudi Arabia, Kuwait, United Arab Emirates, Oman, Bahrain, Qatar), and the developing countries of the Mediterranean.

Part Two on new issues in international trade commences with the paper by David Greenaway on foreign direct investment (FDI) in the EC. The Community is both a major source of, and host to, FDI. The US is also important, both as a host and source, whilst Japan is important as a source but not as a host. EC inward investment is dominated by EFTA, the US and Japan; it is located primarily in the UK, Spain, the Netherlands and France and concentrated principally in banking and finance, food products and chemicals. The key location for outward investment is the US, followed by EFTA; the UK, the Netherlands and France are the main sources; investment goes mainly into energy, chemicals, machinery and transport equipment, and banking and finance. Japan is now the key marginal supplier of inward investment, with the largest flows going to the UK and the Netherlands.

FDI occurs when firms have proprietary assets like reputation or brand image which they wish to exploit in a particular location. Market imperfections of one form or another lead firms to invest directly to exploit such assets, rather than license their product/technology, or engage in trade directly from their home country. FDI promotes international specialization, thereby promoting static and dynamic gains. Concern is sometimes expressed regarding the activities of multinational enterprises, typically focusing on the quality and quantity of employment generated, trade balance effects and income redistribution through transfer pricing. In general these anxieties appear to be exaggerated, and the evidence suggests that the EC has benefited from inward investment.

Investment policy may operate through direct investment measures, or trade-related investment measures: the former are generally incentive measures, the latter disincentive measures. It is clear that many of these instruments have direct trade effects. The 1992 programme for completing the internal market has stimulated a great deal of intra-EC investment flows as well as inward investment, in particular from Japan. Once the single market measures are implemented in full, the scope for independent policy actions on the part of Member States will be further constrained. Adjustment pressures in particular sectors may induce Member States to take action, such as the use of investment policy to attract inward investment to the affected sectors/regions. This necessitates rigorous competition policy and attention being paid to the issue of policy coordination across Member States.

A range of regional and multilateral arrangements or codes have been arrived at, directed largely at setting standards rather than influencing behaviour. The inclusion of trade-related investment measures and subsidies as agenda items on the Uruguay Round provides the opportunity for GATT to become more directly involved in specifying multilateral disciplines to govern the use of investment measures. Progress within GATT cannot be secured by attempting to transpose the provisions which apply to merchandise trade to investment. However, the principles on which trade disciplines are based, most notably national treatment and mutual recognition, should provide the foundation for new disciplines for investment measures. GATT can learn from progress made on intra-EC investment.

In his contribution on services, Patrick Messerlin shows that shares of the major world trading countries for trade in services are similar to their shares for trade in goods. Evidence suggests an early, yet modest, impact of the internal market programme for services on EC trade in services. The growth of intra-EC trade in services is faster than the growth of extra-EC trade, though the intra-EC share of total EC trade remains lower in services than in goods.

Comparative advantage is valid for services as well as for goods, despite the non-storability and intangible nature of services. Moreover, a dualistic specialization pattern, with developed countries completely specialized in services and developing countries completely specialized in goods, is un-

likely. Trade barriers are not the best solution to the complex problems of information or reputation related to the intangibility of services, particularly in the context of 'infant' industries of services. OECD countries' offers at the Uruguay Round tend to cover more sectors than those made by developing countries or NIEs, and the breakdown of the initial offers by sector presents a wide range of liberalization options. Trade liberalization would benefit from the implementation of a multilateral trade policy review of the major policy instruments used by the countries for restricting their trade in services. Such a review mechanism could rely on a taxonomy based on quantitative measures, price instruments and on measures aimed at creating a competitive environment.

There is a fundamental difference between the liberalization approaches of the internal market programme for services and the General Agreement on Trade in Services (GATS). The goal of the single market requires the liberalization of both cross-border-based and establishment-based trade in services, leading to mutual recognition and minimal harmonization. By contrast, GATS defines four 'modes of supply' (cross-border trade, movement of service consumers, movement of service producers, and establishment of service providers in the foreign markets), leaving open the possibility to liberalize only certain modes of supply. In particular, liberalization limited to establishment-based trade may lead to small gains.

Trade-related intellectual property rights (TRIPs) are treated in the paper by Keith Maskus. Trade in intellectual property has increased rapidly in recent years, both through its embodiment in goods and through flows of foreign direct investment and licences for the use of technologies and trade names. This growth reflects, in part, the increasing globalization of business competition as firms employ sophisticated forms of international activity to exploit the economic value inherent in their innovative and creative work. Government measures to protect intellectual property rights such as patents, trade marks, copyrights, and related devices take on greater importance as part of the background rules governing international trade and investment.

In general terms, the EC has two broad interests in the intellectual property area. First, it is important to establish greater harmonization of national policies among the Member States in order to rationalize incentives for engaging in innovative activity and product marketing. Second, continued efforts need to be made through GATT and other multilateral organizations to achieve stronger protection for intellectual property outside the EC, particularly in developing countries.

Stronger levels of intellectual property protection carry certain costs as well as benefits. The essential reason for this trade-off is that, on the one hand, such protection attempts to overcome the dynamic economic problem that infringement limits the returns on innovation, resulting in an underinvestment in new technology and product development. On the other hand, however, protection worsens the static economic problem that new information should be provided to users at marginal cost, which is likely to be too low to compensate innovators fully. Thus, intellectual property protection is inherently a crude solution to problems of a 'second-best' nature and changes in policy could, in principle, raise or lower welfare. Consequently, each policy package needs to be evaluated on a case-by-case basis.

In this context, technologically advanced countries with high-income consumers that have a strong preference for great product variety and quality achieve significant dynamic benefits from intellectual property protection. However, even in countries that should gain overall, there is a risk that stronger intellectual property protection could result in high costs for consumers and input users and limited competition and technology diffusion. That is why there is a need for an effective competition policy to offset potential abuses of stronger intellectual property rights.

Two annexes at the end of the report contain background material. The first gives a concise overview of Community trade policy, in particular the legal basis, decision-making procedures and the implications of the Treaty on European Union, as well as a detailed presentation of the EC's main trade policy instruments available and specific sectoral arrangements. A second annex provides statistical information on the trade position of the European Community and main trading partners.

Part One

Trade, integration and growth

I — Community trade in the 1980s

Summary

The Community is the leading world trader both in merchandise and commercial services. It also accounts for a major part of the world flows of foreign direct investment. As far as merchandise trade is concerned, over the 1980s the Community benefited from a favourable evolution in terms of trade which has substantially enhanced its real income. Although the upward movement in the Community's relative export prices has been accompanied by a decline in overall export market share in volume terms, taking these two movements together the Community has broadly maintained its market share in value terms.

The relative fall in primary product (and particularly oil) prices has led to a substantial reduction in the share of such commodities in total Community imports. As a consequence of this and other factors (such as the export-oriented development of certain Asian countries) an increasing proportion of Community imports is accounted for by manufactured goods coming from other developing countries, and from the newly industrializing economies (NIEs). The Community has thus become a more important participant in world trade in manufactures.

In 1990, developed countries accounted for some 60% of EC trade, compared to 48% in 1980. This increase has occurred almost entirely at the expense of OPEC countries, whose relative share was down to 9,7% of Community imports in 1990, compared to 27,2% a decade earlier (the share of EC exports to OPEC countries declined from 18,1% to 8,4%). Over the 1980s, EFTA countries and the United States of America together accounted for the largest and increasing share both of EC exports (45% in 1990) and imports (42%). Japan has become a major supplier of the Community market (10% in 1990), but is a relatively less important export market (5%). Trade with Central and East European countries continues to represent a relatively small portion of EC external trade (7% in 1990).

Over the last decade, Turkey, China, Taiwan, the former Yugoslavia, Japan, Thailand, South Korea, Pakistan and Austria, in this order, have made the biggest inroads (in value terms) into the Community market. During the same period, the volume of Community imports increased at an average annual rate of 3,2%. Since the mid-1980s, when the '1992 programme' was launched, imports from the rest of the world have become the most dynamic component of Community trade: between 1986 and 1991, the volume of EC imports rose by 40,3%. At the global level, and even more so in the area of manufactures, the volume of EC imports from third countries has increased more rapidly than intra-EC trade, suggesting that foreign producers have been able to take advantage of the opportunities created by the completion of the internal market.

South Korea, Taiwan, Japan, Turkey, Singapore, Hong Kong, Israel, China and the United States of America, in decreasing order, are the markets where EC exports, in value terms, have expanded more rapidly during the 1980s. EC exports to these countries have increased at a rate two to five times as fast as the average for total Community exports. However, the volume of Community exports increased at a rather slow pace during the 1980s (1,1% per year on average), and has slowed down even further (0,6%) since 1986. EC price competitiveness, which has deteriorated during most of the 1980s, appears to be only partially responsible for the slow export growth in volume terms.

At the end of the 1980s, the Community economy, whose GDP is comparable to that of the USA and about twice Japan's, showed a higher degree of trade openness than either of these countries.

In terms of product composition, the EC import pattern has progressively moved away from commodities and raw materials towards processed manufactures, in particular equipment goods. Manufactures have driven the sustained growth of Community imports during the second half of the decade. The penetration of the EC market by foreign products has risen for most manufacturing sectors, in particular textiles and clothing, footwear and leather goods, motor vehicles and transport equipment, and non-metallic minerals.

During the 1980s, EC imports of high-tech products have been growing at an average annual rate double that of the corresponding EC exports. The effect has been a progressive worsening of the EC trade balance for high-tech products, which has moved from an ECU 5 billion surplus in 1982 to an ECU 23 billion deficit in 1990. At the same time, the export/import ratio has moved from 1,1 to 0,8, pointing to a weakening of the EC competitive position and an increasing dependence on foreign suppliers. The USA remains the Community's main supplier of high-tech products, but its position, as well as that of the EFTA countries, has been substantially eroded by rising EC imports from Japan and the newly industrializing economies.

Manufactures account for more than 90% of total Community merchandise exports. In 1990, more than half of total EC exports of manufactures were accounted for by equipment goods. Industrial machinery and chemicals were the two largest exporting sectors of the EC economy. The

limited expansion of EC exports of high-tech products has been concentrated on the markets of other developed countries, in particular the USA. The modest performance of EC exports of high-tech products is reflected on the major export markets, where EC products have progressively lost market shares largely to the advantage of products from Japan and the newly industrializing economies.

The purpose of this chapter is to provide a brief description of the main characteristics of Community trade during the last decade. The chapter is organized as follows. Section 1 presents the Community's economy and trade in a world context. Sections 2 and 3 examine the development of Community imports and exports, respectively, with particular attention to the terms of trade and export price competitiveness. Section 4 compares the Community's degree of trade openness with other major trade partners. Finally, Section 5 concentrates on Community trade in high-technology products.

1. The place of the Community in the world economy

Although the EC economy accounts for more than one-quarter of world GDP and trade among its Member States plays an important role, its international dimension has been substantially enhanced by growing global economic interdependence.

A few figures may help to set the orders of magnitude of the Community's involvement in world trade. EC exports to and imports of goods from third countries reached ECU 420 and 463 billion respectively in 1990, representing 8,9% and 9,8% of Community GDP. In the same year, Community merchandise trade accounted for 20,7% of world trade,[1] compared to 16,8% for the United States and 9,7% for Japan. The importance of the Community as the leading world trader is not only limited to merchandise trade: in 1990, the Community accounted for 27,1% of world trade in commercial services, ahead of the United States of America (16,1%) and Japan (10,2%). Another important element which increasingly adds to the external economic dimension of the Community is foreign direct investment. Over the period 1985-89, the Community accounted for 37% and 19% of world total outward and inward flows of foreign direct investment, respectively. While Part Two of this issue deals specifically with trade in services and foreign direct investment, this part will concentrate on the Community's trade in goods.

In the early 1980s, Community trade and economic activity were negatively affected by the stagnation of world trade, which bottomed out in 1983 (−3% in volume terms). Since the mid-1980s, the external environment has substantially improved, with the volume of world trade growing at an annual average rate of 6% between 1985 and 1990. Economic growth in North America, the dynamic Asian economies and EFTA countries more than offset the adverse impact on EC exports of poor economic performances in heavily-indebted countries of Latin America and Africa, and in the Middle East. However, around 1990 a long period of sustained economic growth in the industrialized countries came to an end. World trade and output slowed down in 1990 and 1991 as a result of several factors: the temporary rise in oil prices caused by the Gulf War, the weakening of economic activity first in North America and then in Western Europe and Japan, and the deep economic recession in Central and Eastern Europe.

2. Community imports

2.1. Geographical structure of Community imports

A large share of the Community's merchandise trade is accounted for by developed countries, both as an export market and a source of import supply (see Table 82[2]). On the import side, the share of developed countries in Community imports has been greatly affected by major shocks in the relative price of raw materials and in particular fuels. The large price rises of primary commodities during the 1970s led to a significant decline of developed countries as a source of EC imports. The subsequent price erosion of primary commodities, in particular the significant drop in oil prices over the 1980s, have pushed up again the share of developed countries, which in 1990 accounted for 59,7% of total EC imports, up from 46,1% in 1980.

In 1990, EFTA countries as a whole represented the largest import supplier, accounting for 23,5% of total Community imports, that is 6,5 percentage points above the corresponding 1980 level. The USA remained the single most important trading partner, its share of Community imports fluctuating

[1] This percentage excludes intra-EC trade. If one includes intra-EC trade in the value of both Community and total world trade, the share of the EC rises to 39,3%.

[2] All the numbered tables are in Annex II — Statistical information (see page 205).

around 17 to 18% of total EC imports, with a certain acceleration in the late 1980s (see Table 82). Japan's share rose sharply, particularly between 1980 (4,9%) and 1988 (10,7%). In 1990, Japan was the second largest supplier of the Community market after the United States, but it is worth noting that its share has been declining since 1988.

Among the group of developing countries the trends are very divergent. The OPEC countries' share of Community imports fell dramatically from 27,2% in 1980 to 9,7% in 1990, as a result of the fall in oil prices over the 1980s; to a lesser extent, imports from heavily indebted countries in Latin America and Africa have also declined. By contrast, the share of the four Asian NIEs[1] has grown by a factor of almost three since 1980, reaching 5,7% of EC imports in 1990. Although imports from Central and East European countries[2] have recently increased, over the 1980s they accounted for a relatively small fraction of EC external trade. In 1990, the combined share of Central and Eastern Europe in total EC imports was still at a relatively modest 6,8%.[3]

In 1990, the former Soviet Union, China and Canada were among the 10 leading suppliers of the Community market, in addition to the United States, Japan and five EFTA countries (see Table 83). Over the last decade, Turkey, China, Taiwan, the former Yugoslavia, Japan, Thailand, South Korea, Pakistan and Austria, in this order, have made the biggest inroads into the Community market. The value of Community imports from these countries has increased by a factor of three to seven, compared to 1,6 for total extra-EC imports. By contrast, the largest market share losses have been experienced by the oil-exporting countries.

2.2. Product composition of Community imports

The product composition of Community imports in value terms has changed substantially over time. The most remarkable feature has been the relative shift away from imports of foodstuffs and primary products towards manufactures. The share of the latter increased to 78% of total EC imports in 1990, compared to 54,0% a decade earlier; at the same time, the corresponding shares of agricultural and energy products declined to 5,9% and 16,0%, respectively, from 9,3% and 36,7% in 1980 (see Graph 1). A number of factors contributed to these developments: the impact of the common agricultural policy, the introduction of natural resource-saving technologies, relative price changes, as well as increasing imports of highly processed goods from the newly industrializing economies. Within manufactures, over the 1980s, imports of equipment goods into the Community have risen at a rate almost twice that of both intermediate and consumer goods, so that in 1990 equipment goods accounted for almost half (45,7%) of all EC imports of manufactured products (see Graph 2).

The decline in the relative weight of raw materials and agricultural products can also be detected when looking at the detailed product breakdown of Community imports. Apart from a few sectors generally affected by specific trade arrangements (textiles, iron and steel, and non-ferrous metals), the share of all other manufactured products has increased substantially between 1980 and 1990 (see Tables 85 and 86).[4] This contrasts sharply with the corresponding drop in imports of non-manufactured products such as mineral fuels, non-fuel raw materials, and food and tobacco.

The increasing importance of manufactured products in the import structure of the Community is parallelled by similar developments in other major developed economies. Over the last decade there has been a major expansion in the share of manufactures imported into the United States and Japan, where the relative importance of energy products shrank by about half (see Table 84). None the less, in 1990, Japan's level (63,2%) was still significantly lower than in the USA (83,3%) and the EC (78,2%).

2.3. Recent trends in Community import volumes

During the period 1980-91, the volume of Community imports from the rest of the world increased at an average annual rate of 3,2%, that is at a somewhat lower pace than the 3,7% corresponding to total EC imports including intra-EC trade (see Table 87). This moderate average growth of Community external imports is largely the result of developments in the first part of the decade. Since the mid-1980s, and in conjunction with the launching of the 1992 programme, extra-EC imports have become the most dynamic component of Community trade: between 1986 and 1991, EC imports from the rest of the world rose by 40,3% compared to 30,7% for intra-EC imports. This strengthening of

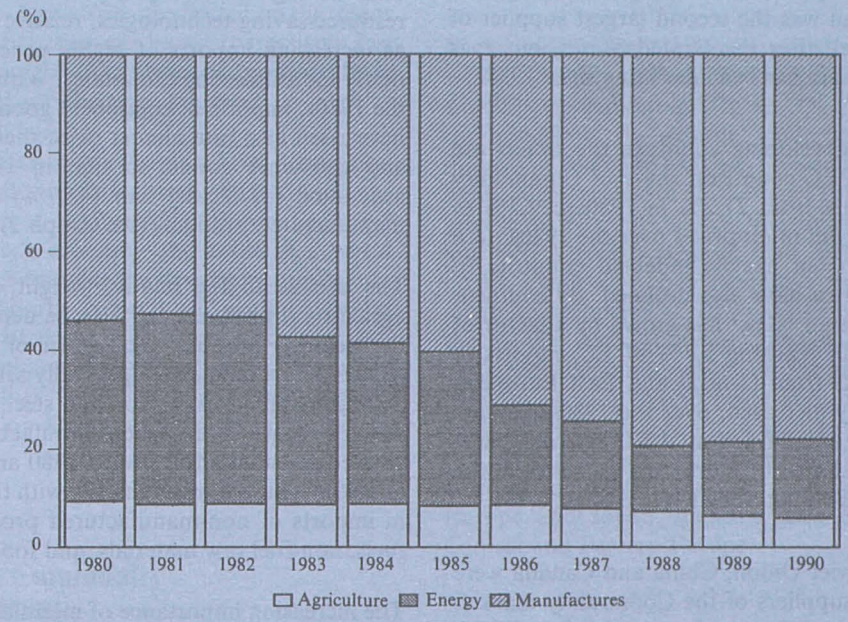
[1] Hong Kong, Singapore, South Korea and Taiwan.

[2] The definition of Central and East European countries used in the text includes eight countries: Albania, Bulgaria, Czechoslovakia, the former GDR, Hungary, Poland, Romania, and the former USSR.

[3] To put it in perspective, in 1990 Switzerland alone accounted for 7,4% of EC imports.

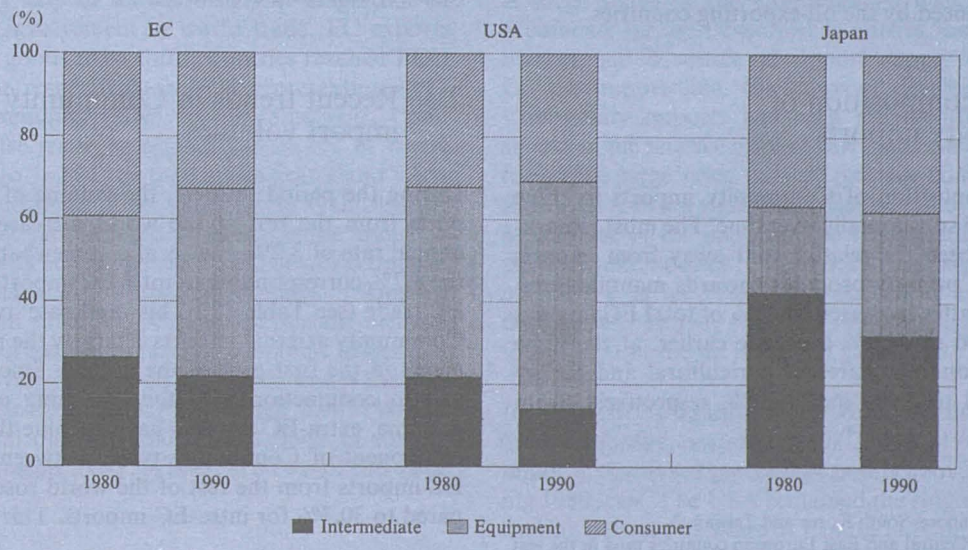
[4] See Table 86 in Annex II for the 40 leading products and a comparison of sectoral trade growth during the last decade.

GRAPH 1: **Share of agriculture, energy and manufactured goods in EC imports**



Sources: Eurostat, Volimex.

GRAPH 2: **Imports of manufactures: share of intermediate, equipment and consumer goods, 1980-90**



Source: Eurostat.

EC import growth is further magnified by the comparison with the 1980-85 period, when import volumes actually fell by 3%.

With an average annual growth rate of 9,1% between 1986 and 1991, manufactures have driven the sustained growth of total Community imports during the second half of the decade. This compares with a lower 7,5% annual growth for intra-EC imports. Hence, at the global level, and even more so in the key area of manufactures, exporters from third countries appear to have been able to take advantage of the opportunities created by the completion of the internal market, outperforming their competitors in the EC Member States.

3. Community exports

3.1. Geographical structure of Community exports

The geographical pattern of Community exports is to a certain extent mirrored by the import developments described above. The share of total exports directed to developed countries has increased substantially during the 1980s, reaching 59,8% in 1990 from 49,6% a decade earlier (see Table 82). In 1990, EFTA markets accounted for more than a quarter (26,5%) of Community exports. The United States represented the second largest market with 18,2% of Community exports in 1990, compared to only 12,8% in 1980. The expansion of EC exports on the American market has been particularly vigorous in 1984-85, in conjunction with the appreciation of the US dollar. The share of EC exports to Japan doubled between 1984 and 1990 to 5,4%. However, despite the significant growth of Japan as an export market, in 1990 Switzerland (9,8%), Austria (6,4%) and Sweden (5,7%) each still represented larger outlets for Community merchandise exports.

The share of EC exports to developing countries decreased to 33,6% in 1990, from 45,9% in 1980. Over the same period, the substantial fall of exports to both OPEC, from 18,1 to 8,4%, and Latin American countries, from 6,1 to 3,6%, more than outweighed the marked increase of EC exports to the Asian NIEs, whose share more than doubled to 5,5% in 1990 (see Table 82). With 8,1% of total EC exports in 1990, the group of fast-growing Asian countries (Asean plus NIEs) has become a larger market for Community exporters than all Central and Eastern Europe, where only 6,7% of EC exports were directed. It is, however, worth noting that in 1990 the former Soviet Union and Yugoslavia still ranked among the 10 leading individual markets for Community exports (see Table 88). The markets where EC exports have expanded more rapidly during the 1980s are mostly those of fast growing countries in the Far East. They include, in decreasing order, South Korea, Taiwan, Japan, Turkey, Singapore, Hong Kong, Israel, China and the United States. Exports to these countries have increased at a rate two to five times as fast as the average for total Community exports.

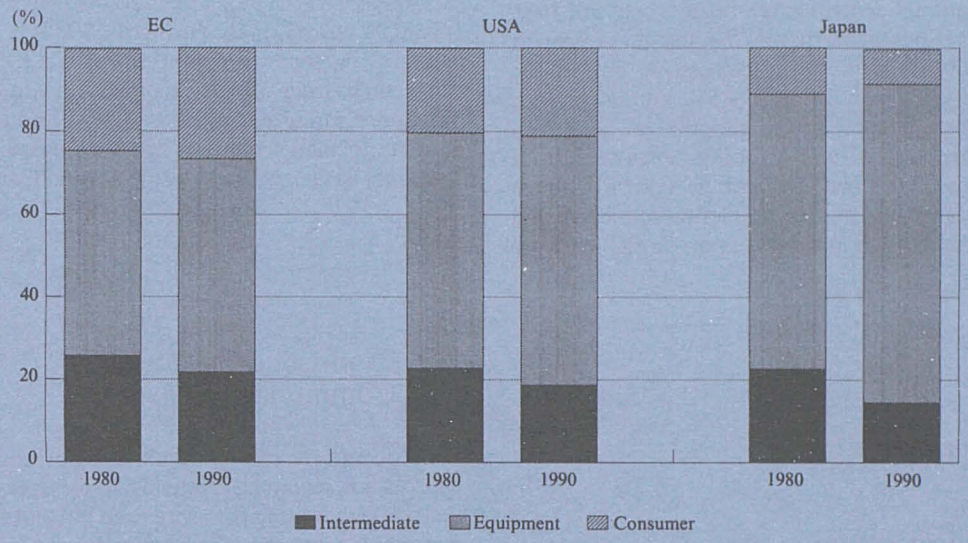
3.2. Product composition of Community exports

Unlike imports, the product composition of Community exports has remained relatively stable over time, with manufactures accounting for more than 90% of total merchandise exports. During the 1980s, a similar export structure can be observed for Japan and the United States, although for the latter the growth of manufactures has been associated with the relative decline as a major exporter of farm products (see Table 84).

The thrust of Community exports of manufactured products increasingly consists of equipment goods, which in 1990 accounted for 51,7% of total EC exports of manufactures. The share of consumer goods has increased slightly over the 1980s (to 26,7% in 1990), whereas the relative importance of intermediate goods has been declining, particularly since the mid-1980s (see Graph 3). This export structure is only partly reflected in the corresponding export structure of the United States and even less in the case of Japan, where the share of equipment goods is significantly more pronounced (77,0% in 1990). On the other hand, EC exports appear to rely more heavily on consumer goods than both those trade partners.

Industrial machinery (15,3%) and chemicals (12,3%) are the two largest exporting sectors of the EC economy (see Table 85). The relative growth of exports at a finer sectoral level provides mixed indications as to the pattern of specialization: sectors where EC exports, in value terms, have increased more rapidly over the last decade include intermediate goods (like plastics in primary forms, organic chemicals), equipment goods (transport equipment, electrical and power-generating machinery), as well as consumer goods (certain food products, clothing, and beverages) (see Table 86).

GRAPH 3: **Exports of manufactures: share of intermediate, equipment and consumer goods, 1980-90**



Source: Eurostat.

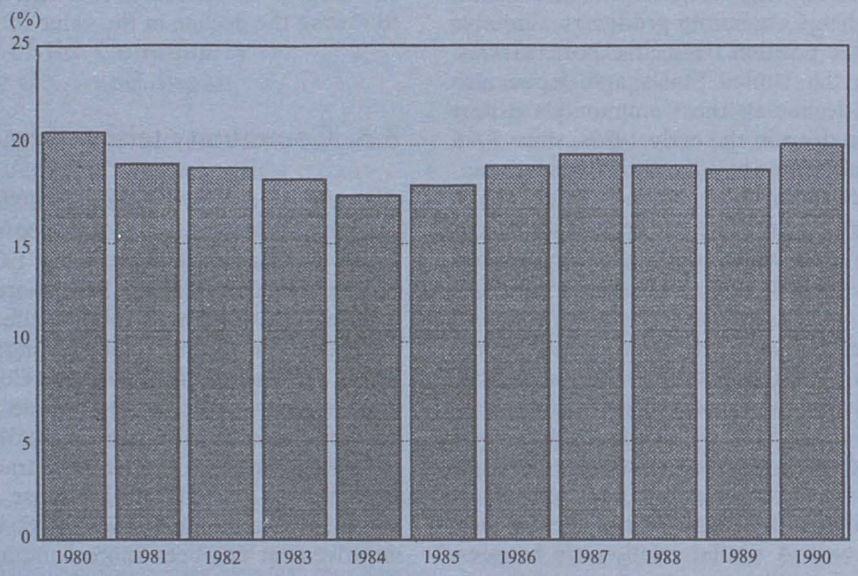
3.3. Recent trends in Community export volumes

During the last decade, the volume of Community exports to the rest of the world increased at a rather slow pace, 1,1% per year on average. The annual growth rate actually declined over the period 1986-91, when it dwindled to an average 0,6% (while imports were growing at 7%). This modest performance on the world markets is somewhat outweighed by the more rapid expansion of intra-EC exports which sustained the export pattern of nearly all Member States (see Table 87). The growth of export volumes for manufactures has been even more sluggish, with an annual average rate of 0,9% over the entire period, and a poor 0,5% between 1986 and 1991. After a period of stagnation, the temporary export recovery in export volumes during the years 1988-89 has only marginally improved the relatively poor performance of Community exports on world markets, as indicated by the poor results in 1990 (−0,3%) and 1991 (−0,1%).

3.4. Export market shares and price competitiveness

Since 1985 the Community market share of world exports has recovered most of the ground lost in the early 1980s, and its 1990 level (20,0%) was roughly comparable to that of a decade earlier (see Graph 4). This recovery in value terms stems from the combined effect of a decline in the EC export volumes and by increasing export prices. Table 1 compares the export volume market share and the relative price competitiveness for the Community, Japan and the United States. The market share indicator is defined, on the basis of aggregate trade data, as the difference between annual export volume growth and the growth of world demand. The competitiveness variable measures the difference between the growth rate of export prices of competitors and the growth rate of EC export prices. The two variables are expected to be positively correlated, so that an improvement in price competitiveness (e.g. EC export prices increase less than its competitors' prices) should boost export volume market shares.

GRAPH 4: **Share of EC exports in total world exports of goods[1] (current prices)**



[1] Excluding intra-EC exports.
Sources: Eurostat and GATT.

Table 1

Gains in export volume market shares and price competitiveness 1973-90

(% average annual growth changes)

	1981/1973	1982	1983	1984	1985	1986	1987	1988	1989	1990	1990/1982
Community											
Gain in market shares	0,2	−3,0	−5,7	−8,8	−0,6	−7,3	−3,0	−4,6	−0,9	−1,7	−4,0
Gain in price competitiveness	2,8	−0,6	−1,2	2,5	−5,3	−20,9	−12,4	−4,9	1,9	−10,7	−5,7
United States											
Gain in market shares	0,0	−4,9	−7,3	−0,6	−8,1	0,2	8,5	6,0	4,6	4,0	0,3
Gain in price competitiveness	1,0	−6,1	−7,1	−4,1	−2,1	5,6	6,6	−0,3	−0,6	10,5	0,3
Japan											
Gain in market shares	3,0	1,3	0,4	−7,1	−3,2	−8,0	−1,6	−0,3	−2,1	6,0	−1,6
Gain in price competitiveness	2,4	3,4	−2,4	−1,8	−1,6	−15,9	−1,6	−5,5	2,3	11,1	−1,3

Note:
Gains in export volume market shares are defined as the difference between the average annual growth of export volume (for the Community: extra-EC) and weighted world import volume (for the Community: extra-EC). A plus (minus) indicates an increase (decrease) in the market share of the country.
Gains in price competitiveness are defined as the difference between the average annual growth of double-weighted competitor's export prices (for the Community: extra-EC) and the export price (for the Community: extra-EC).
A plus (minus) means that export prices of the country increase less (more) than export prices of its competitors.
Sources: Eurostat, Trend, Volimex databank and Quest model.

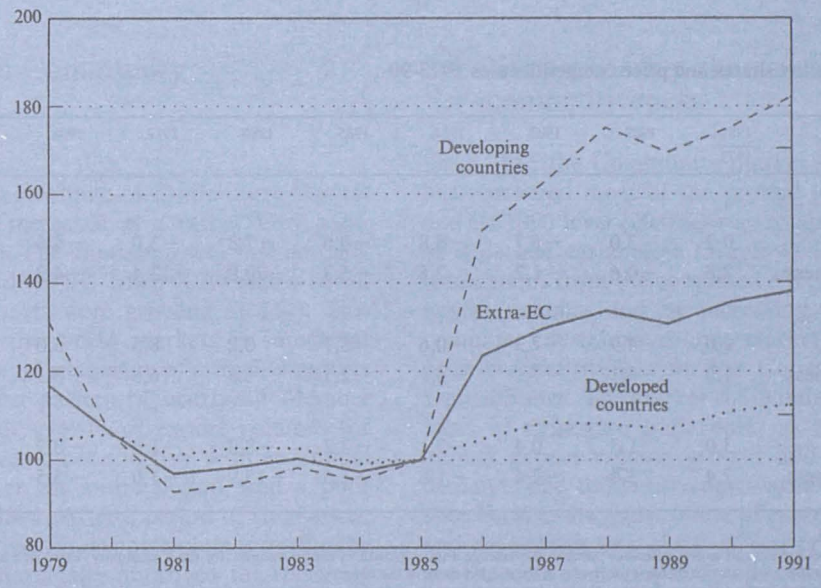
Over the 1982-90 period there has been a continuous decline in the Community's export market shares (in volume terms) on the world markets, with a negative differential of some 3,9% compared to its trade competitors. This contrasts with the previous decade when Community producers were able to improve their relative position on their export markets. The comparison with the United States and Japan also confirms the relative decline in the Community's export capability. Following a drop in the early 1980s, since 1986 American export market shares have been recovering steadily, boosted by the US dollar depreciation. In the case of Japan, the loss of export market share has been concentrated in the years 1984-89 while a considerable improvement has taken place in 1990.

EC price competitiveness has been deteriorating during most of the 1980s and, judging from the averages over that period, must be seen as the major factor behind the evolution of export market shares: the direction and the magnitude of the changes in price competitiveness are on average reflected more than one-for-one in the corresponding movements in the export market shares, although non-price factors may have played a role as well. A similar relationship between export volumes and price competitiveness seems to hold on average for the United States and Japan. Thus, for example, the recovery of the American export market share since 1986 can largely be related to the increase in competitiveness following the decline in the value of the US dollar.

3.5. Community terms of trade

As mentioned above, over the 1980s the relative price of primary commodities has dropped significantly compared to the manufacture component of EC imports. At the same time, the relative price of EC exports has been growing at a faster rate compared to its trade partners, also due to movements in the nominal exchange rates. Since the mid-1980s, this has translated for the Community into a major improvement in the terms of trade, which rose by 38,1% between 1985 and 1990 (see Graph 5). Most of the improvement has concerned the terms of trade with the developing countries, in particular with those relying mostly on oil and other basic commodities for their exports, whereas the improvement has been more contained *vis-à-vis* the newly

GRAPH 5: **Community terms of trade (trade in goods, 1985 = 100)**



Source: Eurostat, Trend.

industrializing economies in the Far East.[1] As imported products became cheaper in terms of exported goods, the Community's real income has been substantially enhanced.

4. Trade openness of the Community compared to the USA and Japan

The ratio of trade to gross domestic product provides a rough measure of the degree of openness of an economy. Trade can be defined as the value of imports, exports or a combination of both. Many factors intervene in determining the degree of openness, among which the size of the economy, its location *vis-à-vis* other trade partners, the degree of economic development, historical links, as well as the policies undertaken play a relevant role. In the short term, changes in the relative price of different categories of products and exchange-rate movements also have a significant impact on the degree of trade openness.

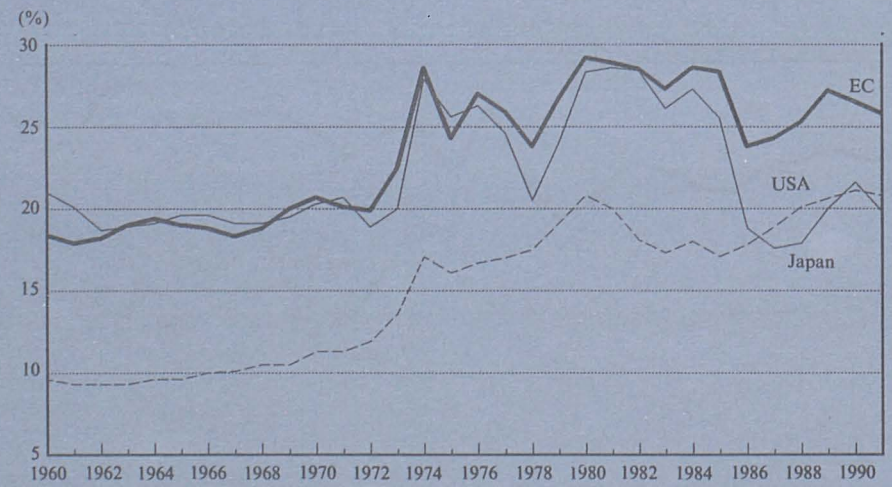
[1] The price indexes used to calculate the terms of trade in Graph 5 rely on 1985 as the base year. In that year, energy products still accounted for almost one third of total EC imports, compared to only 16% in 1990. This may tend to overestimate the improvement in the Community terms of trade by giving a larger weight to energy products, without taking into full account the expanding share of imported manufactures.

The share of Community trade of goods and services as a percentage of GDP has been rising over the last three decades (see Graph 6). Such a rising path, however, has been subject to major fluctuations, largely determined by changes in the price of imported food and energy products, and by major shifts in the value of the US dollar, in which most commodities are usually priced. At the end of the 1980s the Community economy, whose GDP is comparable to that of the USA and about twice Japan's, showed a higher degree of openness than either of these countries.

Excluding energy products from the trade values reduces measurement problems linked to commodity price volatility. The resulting measure of trade openness (see Graph 7) confirms the upward trend for the Community, and accentuates the increasing role of trade for the American economy.

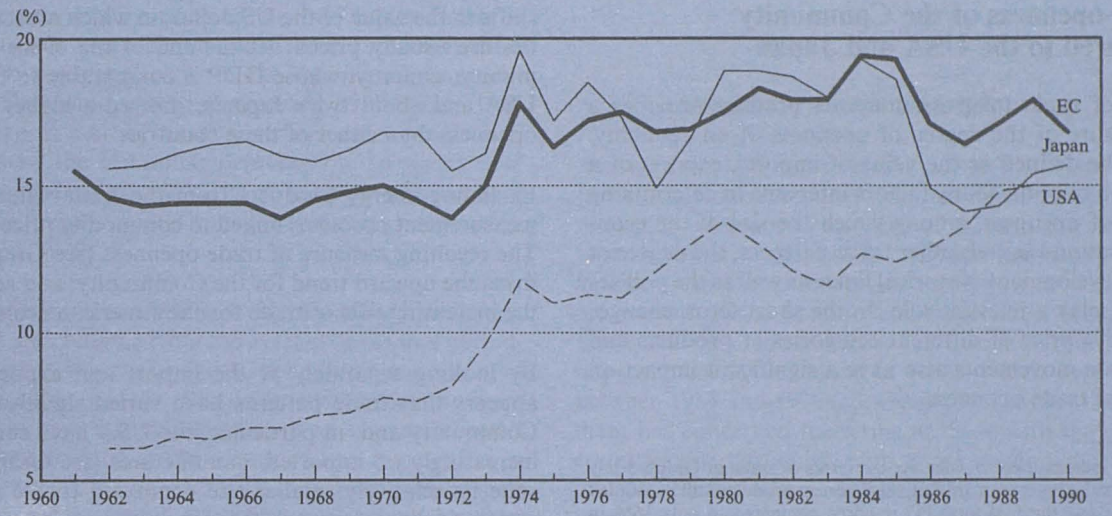
By looking separately at the import and export sides, it appears that trade patterns have varied significantly. The Community and, in particular, the USA have come to rely increasingly on imported manufactures (see Graph 8). Despite its relatively smaller size compared to the other two major trading partners, the Japanese economy has been characterized by a downward trend which has actually reduced an already low level of import penetration (by the

GRAPH 6: **Trade[1] in goods and services as a percentage of GDP (current prices)**



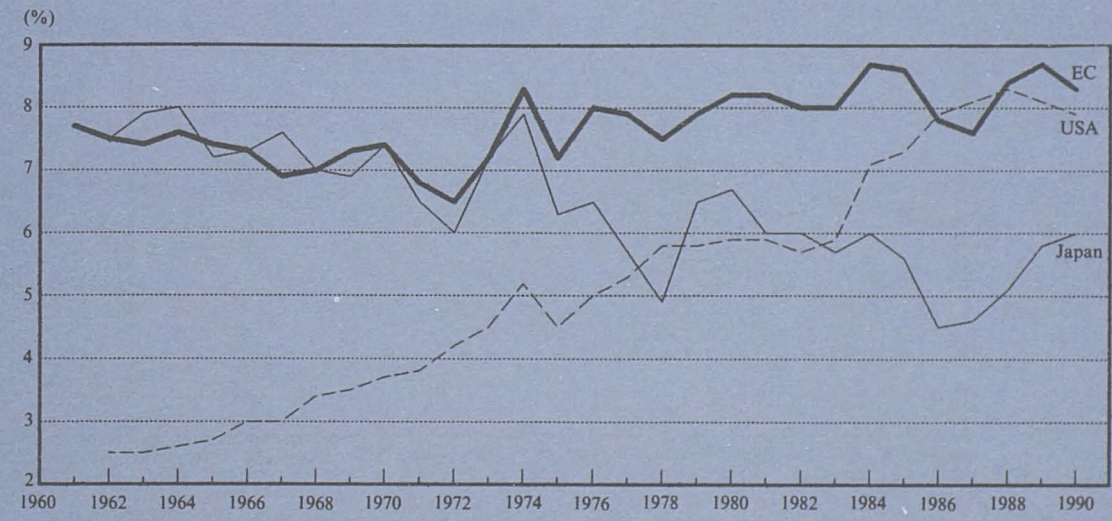
[1] Exports plus imports at current prices. Trade in services apportioned between extra- and intra-EC in the same proportion as trade in goods.
Source: Commission services.

GRAPH 7: **Merchandise trade[1] (excluding energy products) as a percentage of GDP (current prices)**



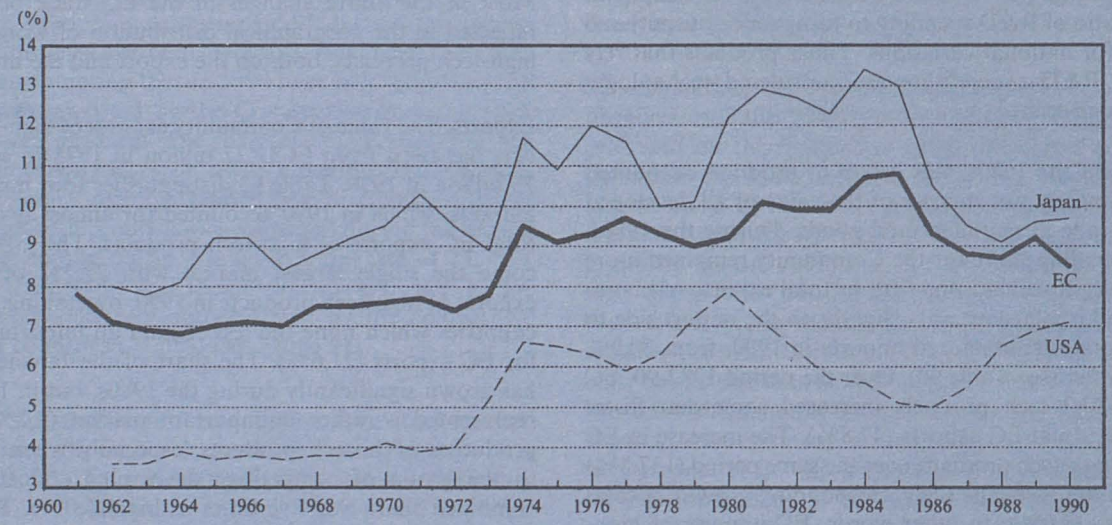
[1] Average of imports and exports (extra-EC only for the Community).
Source: Commission services.

GRAPH 8: **Share of imports of goods (excluding energy products) as a percentage of GDP**



Source: Commission services.

GRAPH 9: **Share of exports of goods (excluding energy products) as a percentage of GDP**



Source: Commission services.

late-1980s the Japanese import ratio was still considerably lower than for both the Community and the USA). In particular during the 1980s, the surge in American imports (the imports to GDP ratio peaked in 1988 at 8,3%) contrasts with the relative stability for the EC (above 8%) and Japan's actual decline (from 6,7% in 1980 to 6,0% in 1990). Since the mid-1980s, however, there has been a clear inversion in the Japanese trend, with a rising share of imports. Over the 1980s, import penetration of the Community market increased for most manufacturing sectors and, in particular, textiles and clothing, footwear and leather goods, motor vehicles and transport equipment, and non-metallic minerals (see Table 89).[1] Chemicals, timber, wooden furniture and food products are the only sectors where import penetration actually declined during the 1980s; it is apparent that in the case of food products, the common agricultural policy has played a relevant role in checking the expansion of foreign imports.

[1] The definition of import penetration used in Table 89 in Annex II is somewhat different from the one used in the text, as imports are related to 'apparent consumption' rather than to GDP. The main difference consists in using output plus net imports instead of value added as the ratio denominator. This represents a better measure of the share of domestic demand met by foreign products as both numerator and denominator include the value of intermediate goods.

On the export side, differences are less striking (see Graph 9). A significant expansion in the export openness of the Community and especially Japan took place between the early 1970s and 1985; in the case of the United States, the share of exports progressed until 1980 and then declined dramatically in the first half of last decade, in conjunction with the US dollar appreciation. Since the mid-1980s, the shares of EC and Japanese exports in GDP have dropped considerably, while the corresponding share for American exports rose steadily.

5. Community trade in high-technology products

Particular importance is generally attached to trade in 'high-technology' products, since they tend to be one of the most dynamic components in world trade, and are often regarded as instrumental in maintaining or improving an economy's competitive edge *vis-à-vis* other trade partners. Although price remains an important element of competitiveness, non-price factors, like the ability to innovate in the presence of rapid technological progress, play a major role in determining the overall level of competitiveness.

This section provides a brief overview of Community trade in high technology products in relation to other major trade partners. The definition of high technology products used for this purpose is based upon the classification of each industry according to its level of research and development intensity (ratio of R&D spending to turnover or output) and controlled for national variations. Those products that rely heavily on R&D expenditure are considered technology-intensive (high-tech).[1]

By the end of the 1980s, this group of products accounted for approximately one-quarter of the value of all developed countries' trade in manufactured goods. During the 1980s, the corresponding share for the Community remained more or less stable, at around one-fifth of total exports of manufactures, and it increased only slightly on the import side to 31,4% of total manufactured imports in 1990, from 30,9% a decade earlier (see Table 90). Over the period 1982-90, EC exports of high-tech products increased somewhat faster (59,5%) than total EC exports (47,8%). The increase in EC imports of high-tech products over the same period (137,8%) was three times as big as the corresponding growth of total EC imports (38,0%). In other words, EC imports of high-tech products have been growing at an average annual rate of 11,4%, double that of the corresponding EC exports (6,0%) (see Table 91). The effect has been a progressive worsening of the EC trade balance for high-tech products, which has moved from an ECU 5 billion surplus in 1982 to an ECU 23 billion deficit in 1990.

Another measure of the Community's trade performance is given by the export/import ratio for high-tech products, whereby a ratio in excess of unit reflects a trade surplus and a ratio of less than unit a trading deficit (see Table 92). The decline in the EC ratio from 1,1 in 1982 to 0,8 in 1990, with respect to the ensemble of its partners, reflects the shift in the trade balance from a surplus to a deficit. Only with the USA has the Community position improved over the period; EC net exports of high-tech products *vis-à-vis* all other trade partners have deteriorated. The most dramatic deterioration in the trading balance of the Community has occurred with the group of 'competitive developing countries'.[2] In 1990 a positive ratio appeared only for EC trade with the EFTA countries. Hence, all indicators point to a weakening of the EC competitive position and an increasing dependence on foreign suppliers.

Most of the above changes in the EC trade position are reflected in the geographical distribution of world trade in high-tech products, both on the export and the import side.

Exports. The value of Community exports of high-tech products has risen from ECU 27 billion in 1978 to some ECU 73 billion in 1990. Table 93 distinguishes four major export markets, which in 1990 accounted for almost two-thirds of total EC exports of high-tech products. The USA has become the single largest market with 22,7% of total EC exports of high-tech products in 1990, overtaking the EFTA countries which none the less remain an important market for EC exports (21,6%). The share of the Japanese market has grown significantly during the 1980s, but in 1990 it still represented a rather unimportant market (3,2%) for EC producers of hi-tech products, especially when compared to the group of competitive developing countries whose combined share was five times as big (16,0%). The rate of growth of EC exports of high-tech products has generally been lower through the period 1986-90 than in the earlier period 1982-86, with the exception of exports directed to the group of competitive developing countries (see Table 91). Between 1986 and 1990, EC high-tech exports actually increased at a lower pace (16,7%) than total EC exports (22,8%).

American exports of high-tech products are increasingly directed to the markets of the competitive developing countries but also to Japan (the latter's share almost doubled to 11% in 1990). Although Western Europe remains a major market for American exporters, its relative share has either risen marginally, in the case of the Community, or actually declined, in the case of the EFTA countries. This points to a reorientation of American exports towards more dynamic markets outside Europe.

The US and the Community markets account for the largest, and expanding, share of Japanese exports of high-tech products (with the two markets combined absorbing some 60% of the total in 1990), whereas a certain deterioration occurred in the relatively less important EFTA market. Between 1986 and 1990, however, Japanese exports became more oriented towards the competitive developing countries at the expense of the American market. Not surprisingly, an increasing share (52,1% in 1990) of the ETFA countries' exports of high-tech products is directed to the Community market.

Imports. On the import side, the EC market for high-tech products has experienced a five-fold rise since 1978, to attain

[1] The resulting aggregate, constructed by Eurostat, comprises 130 individual products defined according to the Standard International Trade Classification (SITC, Revision 2). For a complete explanation of the methodology used to construct the data and the list of high-tech products, see Eurostat (1989), *Statistical analysis of extra-EC trade in high-tech products*, in particular pp. 9-13 and 107-112.

[2] This composite group includes Argentina, Brazil, Hong Kong, India, Indonesia, Israel, Macau, Malaysia, Mexico, Philippines, Singapore, South Korea, Taiwan, Thailand and the former Yugoslavia.

ECU 96 billion in 1990. In 1990, over 80% of EC imports came from the four suppliers shown in Table 93. The USA remained the main Community supplier of high-tech products (35,4% in 1990), but its position has been substantially eroded by rising EC imports from Japan (21,6%) and the competitive developing countries (15,9%); the latter's share has nearly doubled between 1978 and 1990 (see Table 93). It is also worth noting that in 1990 over half (52,1%) of all manufactures imported by the Community from the USA were high-tech products. The share of EC imports from the EFTA countries (15,2% in 1990) has also declined since 1978. The annual average growth rate of Community imports of high-tech products was sustained during the second part of last decade (at an annual average rate of 11,7%), with the USA (10,1%), Japan (9,2%) and the EFTA countries (9,2%) clearly outperformed by the competitive developing countries (21,0%) (see Table 91).

The same situation is mirrored in the American market, where imports of high-tech products from Japan (whose share reached 33,7% in 1990) and, in particular, the group of competitive developing countries (34,2%) have displaced imports from the Community and EFTA (see Table 93).

Japan is still relying mostly on the USA (57,1% in 1990) for its imports of high-tech products, but the competitive developing countries are gaining considerable ground (21,3% in 1990). A clear downward trend can be detected for Japanese imports of high-tech products from the Community (from 20,6% in 1978 to 13,2% in 1990) and the EFTA countries. Finally, on the EFTA market only the share of imports from the Community (52,4% in 1990) has declined between 1978 and 1990, largely to the advantage of products originating in Japan and the competitive developing countries.

To summarize, the expansion of EC exports of high-tech products over the 1980s has been sluggish and mostly concentrated on the markets of other developed countries, in particular the USA. At the same time, there has been a reorientation of American exports towards non-European markets, while the growth of Japanese exports has relied primarily on the American and EC markets. The already high dependence on the EC market of EFTA countries' exports has further increased over the last decade. The USA remains the main Community's supplier of high-tech products, but its position, as well as that of the EFTA countries, has been substantially eroded by rising EC imports from Japan and the competitive developing countries. The modest performance of EC exports of high-tech products is reflected on the import side of its main trade partners, where EC products have consistently lost market shares. The rise of imports of high-tech products from Japan and the competitive developing countries to the American market has been largely at the expense of Community and EFTA products, which have also lost considerable ground in the Japanese market. The decline of EFTA imports from the EC has been more contained, and EC high-tech products still account for more than half the EFTA market.

II — Regional integration and trade

A — Regional integration: an introductory note

1. Introduction

Regional economic integration in Europe was launched in earnest more than 30 years ago. In the late 1950s, three (partly rival) regional schemes were established: the European Economic Community (EEC), with six members (Belgium, France, Germany, Italy, Luxembourg and the Netherlands); the European Free Trade Association (EFTA), with seven members (Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the United Kingdom — Iceland and Finland joined later); and the Council of Mutual Economic Assistance (CMEA), with eight members (Albania, Bulgaria, Czechoslovakia, the GDR, Hungary, Poland, Romania and the Soviet Union).

These three schemes, and their relationship with one another, have evolved considerably over the years.

The EEC — which meanwhile became the European Community (EC) — has both deepened and widened. From a mere customs union with six members, it has matured into a fully-fledged single market with 12 members (the original six plus Greece, Denmark, Ireland, Portugal, Spain and the United Kingdom) increasingly sharing common micro- and macroeconomic policies. Three phases of trade liberalization within the EC can be distinguished. The first, starting in 1958, was the elimination of customs duties and quantitative restrictions. It was completed in 1968 with the introduction of a common external tariff. The second, between 1973 and 1986, witnessed successive enlargements from six to twelve members. The last, ending in 1992, is the completion of the internal market for goods, services, capital and labour.

Concurrently, the relationship of EFTA with the Community has been sharply transformed. Since 1973, the members of EFTA and the Community have constituted an umbrella free trade area which has permitted the free circulation of manufactured goods. From 1993, the newly formed European Economic Area (EEA) will allow unrestrained circulation of manufactured goods, services, capital and labour between the EFTA and the Community. And by 1995, a certain number of present EFTA members could join the Community.

Changes in the CMEA have been even more dramatic. As a result of political and institutional transformations in Eastern Europe since 1989, the CMEA collapsed. It was formally dissolved in 1991. The following year, Czechoslovakia, Hungary and Poland signed free trade agreements with the Community, and similar arrangements are under way for Bulgaria and Romania.

The network of regional arrangements which has emerged around the Community (see Table 2) can be described as a European trading bloc. The possibility of similar regional arrangements in America (around the United States) and Asia (around Japan) raises the spectre of the end of multilateralism as the world economy fragments into three conflicting regional trading blocs. This prospect is at the centre of much controversy among academic economists and policymakers alike.[1]

The remainder of this short paper is divided into two substantive parts. Section 2 focuses on EC integration and examines its impact on trade. Section 3 deals with the issues of regionalism versus multilateralism and regional trading blocs. Section 4 concludes.

2. The impact of EC integration on trade[2]

The extent of regionalization is commonly measured by the share of intra-area trade in total trade, where trade refers to exports and/or imports. An increase in the intra-area share is taken as verification of the effect of regionalization on trade flows. However, as Lloyd (1992) notes, this can only be considered as weak evidence since changes in the intra-area share capture many other effects besides integration.

The regional structure of total EC-12 merchandise trade for the period 1958-90 is reported in Table 3.[3] For the moment examination will focus entirely on the first column, which shows the share of intra-EC trade in total EC trade. As far as exports are concerned, the figures confirm the three phases of integration presented in the Introduction. The share of intra-EC exports increased steadily following the Treaty of Rome, jumping from less than 40% in 1958 to nearly 55% in 1970. It remained roughly constant until 1985 and increased again thereafter, scoring over 60% in 1990.[4]

The picture is similar on the import side, but here the composition of trade has added a strong price component to the evolution in the share of intra-EC trade. Whereas the Community exports mainly manufactures whose price fluctuates little, it imports large quantities of raw materials which have undergone large price fluctuations during the period under investigation. The share of intra-EC imports for all merchandise commodities rose from 35% in 1958 to

---

1 For opposite views, see, for instance, Bhagwati (1992) and Summers (1991).

2 This section draws heavily on Sapir (1992).

3 EC-12 refers to the present 12 EC members.

4 A year-by-year examination of the data confirms that 1985 corresponds to a structural break in the series. In 1981, 1982, 1983 and 1984 the intra-EC export share was 53,2, 54,4, 55,0 and 54,6%, respectively. It was 57,4, 58,9, 59,8 and 60,2%, respectively, for 1986, 1987, 1988 and 1989.

Table 2

Network of EC regional agreements

Year	Benelux France Germany Italy	Denmark Ireland UK	Greece	Portugal	Spain	Austria Finland Iceland Norway Sweden Switzerland	Czecho-slovakia Hungary Poland	Bulgaria Romania	Turkey	Malta	Cyprus	Yugoslavia	Maghreb	Mashreq	Israel	ACP countries
1958	Membership															
1961			Association Agreement													
1963									Association Agreement							Association Agreement (Yaoundé)
1970					FT Agreement					Association Agreement						
1973		Membership		FT Agreement		FT Agreement					Association Agreement					
1975															FT Agreement	Association Agreement (Lomé)
1976													Cooperation Agreement			
1977														Cooperation Agreement		
1980												Cooperation Agreement				
1981			Membership													
1986				Membership	Membership											
1992							Europe Agreement									
1993						EEA Agreement		Europe Agreement								

Table 3

The regional structure of EC-12 trade, 1958-90

(As a percentage of total EC-12 trade)

Year	Western Europe			Eastern and southern neighbours				Rest of the world			Total
	EC-12	EFTA	Total	Eastern Europe	Mediterranean countries	ACP	Total	Developing countries	Industrial countries	Total	
					Exports						
1958	37,2	12,2	49,4	2,7	7,8	6,6	17,1	15,3	18,2	33,5	100,0
1965	49,6	13,0	62,6	2,9	4,8	4,4	12,1	9,4	15,9	25,3	100,0
1970	53,4	11,7	65,1	3,4	4,8	3,6	11,8	7,1	16,0	23,1	100,0
1975	52,4	10,6	63,0	4,9	6,7	3,6	15,2	9,6	12,2	21,8	100,0
1980	56,1	11,2	67,3	3,5	5,9	3,5	12,9	9,2	10,6	19,8	100,0
1985	55,2	10,0	65,2	2,8	5,2	2,3	10,3	8,7	15,8	24,5	100,0
1990	61,2	10,4	71,6	2,3	4,2	1,6	8,1	7,3	13,0	20,3	100,0
					Imports						
1958	35,2	9,3	44,5	2,9	4,5	6,8	14,2	19,2	22,1	41,3	100,0
1965	44,9	9,0	53,9	3,4	4,7	5,2	13,3	12,7	20,1	32,8	100,0
1970	50,3	8,7	59,0	3,2	4,7	4,4	12,3	10,3	18,4	28,7	100,0
1975	49,5	7,9	57,4	3,5	3,8	3,8	11,1	16,3	15,2	31,5	100,0
1980	49,3	8,6	57,9	3,7	4,2	3,8	11,7	15,6	14,8	30,4	100,0
1985	53,4	9,4	62,8	3,9	5,1	3,5	12,5	9,8	14,9	24,7	100,0
1990	59,0	9,6	68,6	2,7	3,8	1,8	8,3	8,2	14,9	23,1	100,0

Source: Eurostat.

nearly 55% in 1973. It plunged below 50% in 1974-76, after the first oil-price shock, and again in 1980-81, after the second oil-price shock. There was a significant rise after 1985.[1]

A more instructive picture of the share of intra-EC imports can be obtained by focusing on processed products. This was done by Jacquemin and Sapir (1988a), who examined EC-10 imports for the period 1963-83.[2] They found that the share of intra-EC imports for all processed goods behaved differently before and after 1973.[3] During the first period, there was a steady increase in the share from 51 to 61%. There was stagnation thereafter, with an eventual decline to around 58%. More recent figures indicate that this trend has not been reversed to date.

Jacquemin and Sapir (1988a) also examined the evolution in the share of intra-EC imports for individual Member States and individual industries or sectors (i.e. groups of industries). In the former, they observed an interesting convergence phenomenon between old and new members after the first enlargement in 1973. This resulted from a decrease in the share of intra-EC imports for the old members and an increase for the new.[4]

They also found important differences across sectors and industries. It turned out that the evolution observed at the aggregate level after 1973 was the result of three different trends: a declining share in engineering products (NACE sector 3), stagnation in ore processing and chemicals (NACE sector 2), and a rising share in other manufactures and processed agriculture (NACE sector 4). More recent figures show that these trends have continued, at least until 1991.

Wide differences of behaviour across sectors and industries confirm that import shares are affected by factors other than EC integration. These include changes in external trade

1 The intra-EC import share was 51,7% in 1984 and 57,9 % in 1986.
2 EC-10 excludes Portugal and Spain.
3 Processed goods as defined here comprise the products of all the industries belonging to sectors 2, 3 and 4 of the NACE classification.
4 A similar phenomenon occurred after the accession of Greece, Portugal and Spain. See also Lloyd (1992) who shows clearly the diverging trends in the share of intra-area imports for EC-6 and EC-12 after 1973.

policy and competitiveness *vis-à-vis* non-EC members. Thus, the continuous decline in the share of intra-EC imports for footwear and clothing reflects primarily the changing comparative advantage of the Community in labour-intensive products. On the other hand, the steady rise in the intra-EC share for processed agricultural products is, probably, a reflection of the common agricultural policy (CAP).

As Lloyd (1992) indicates, the only way to disentangle the effect of regional integration from other effects on intra-area trade shares is to regress these shares on a set of relevant variables. Such an exercise was conducted by Jacquemin and Sapir (1988b) who examined the 1973 and 1983 shares of intra-EC imports in four countries (France, Germany, Italy, and the United Kingdom) and across about 100 NACE 3-digit industries. Three findings from their regression analysis are particularly relevant in the context of the present paper. First, the accession of the United Kingdom to the Community has significantly increased the share of its imports from other Member States between 1973 and 1983.[1] This supports the hypothesis that EC integration has had a substantial impact on trade flows. Second, the presence of non-border barriers among EC members contributed significantly to lowering the share of intra-EC imports for products where scale economies matter. Finally, between 1973 and 1983, the CAP played an important role in boosting the share of intra-EC imports in processed agricultural goods.

In summary, it appears that the share of intra-EC trade has significantly increased since 1958. Although the evidence suggests a strong effect of EC integration, it also calls for two caveats. The first relates to the many other factors which have affected EC trade shares over time, including external trade policy and competitiveness. The second concerns the numerous extensions of EC membership, which have played an important part in maintaining the momentum of integration at the level of EC-12.

3. Regionalism versus multilateralism

As trade economists have long known, regionalism and multilateralism need not conflict with each other. Provided regional integration arrangements adopt a fairly liberal external trade regime, chances are that they benefit world trade. In other words, regional trade liberalization ought to be judged by its contribution to world-wide trade liberalization.

In the area of manufactured products, where the Community has generally adopted a liberal trade policy, EC integration has resulted in trade creation and benefited world trade. Community participation in successive GATT rounds has been crucial in shaping its external trade regime in manufacturing. Its active role in multilateral trade negotiations was dictated partly by its own liberal charter and partly by the insistence of its trade partners, most notably the United States.

European integration was the main driving force behind the Dillon and Kennedy rounds of multilateral trade negotiations which produced substantial tariff reductions. The process of EC integration was a catalyst in the reduction of Europe's external protection. This view seems to be shared by most authors.[2] For instance, Hufbauer (1990) states that 'France and Italy, in particular, would have strongly resisted making any trade concessions in the 1960s, and Germany would not have made trade concessions in isolation from its continental partners.' (p. 5). Regarding France, Messerlin (1992) notes that the 'first impact of the Treaty of Rome was to impose ... [a] macroeconomic environment [which] allowed the progressive opening of the French economy ... . As a result, the protection granted to the French manufacturing sector *vis-à-vis* both the Community and the rest of the world ... decreased during the 1960s.' (p. 159).

The simultaneous lowering by the Community of its internal and external protection in manufacturing did not end with the Kennedy Round in the late 1960s. The first enlargement of the Community, in 1973, was followed by multilateral tariff cuts on manufactured goods during the Tokyo Round, which was completed in 1978. And the third enlargement, in 1986, was immediately followed by the launching of the still-unfinished Uruguay Round.

The situation in temperate agriculture has run counter to that in manufacturing, with trade diversion instead of trade creation. The root of the problem lies with the *de facto* exclusion of temperate agriculture from the GATT.

At the end of the day, the evidence strongly suggests that the process of EC integration has been beneficial to both the Community itself and its trading partners. This favourable outcome is, to a large extent, due to the fact that integration has led to substantial multilateral trade liberalization, beyond what could have materialized without the Community. As Lawrence (1991) noted: 'The postwar experience of the EC is heartening. Increasing European integration after the Treaty of Rome was quite compatible with the lowering of

[1] The United Kingdom joined the European Community in 1973.

[2] For a dissenting view, see Winters (1992).

Europe's external barriers.' (p. 26). The obvious exception is agriculture.

Some might, however, wonder whether the Community is likely to maintain its active support in favour of the multilateral trade system. Those who worry point to two developments. The first concerns the network of regional agreements built around the Community and is described in Table 1. Half the share of extra-EC trade is accounted for by trade with regional partners: EFTA, Eastern Europe and southern neighbours (Mediterranean and ACP countries). If one adds this to the share of intra-EC trade, one can observe that roughly 80% of EC trade is intra-regional (see Table 3). The second concern relates to the parallel movement towards regionalism in America and Asia.

The emergence of a tripolar world raises vital questions. In the coming years, regionalism can either contribute to or be detrimental to the multilateral trading system. The two scenarios are possible and correspond to a distinction between what Jacquemin and Sapir (1991) have described as 'natural integration' and 'strategic integration'.

The former situation involves 'natural' trading partners geographically close to one another, which adopt a liberal trade policy *vis-à-vis* third countries. Strategic integration, on the other hand, refers to a situation where member countries pursue a common trade policy at the expense of third countries. Obviously, natural integration could lead to strategic integration. If the three blocs decide to play a non-cooperative game, natural integration could, indeed, be used as a leverage for strategic conduct, with detrimental consequences for all.

4. Concluding remarks

The previous sections suggest that EC integration has been successful. It has had a significant impact on intra-EC trade. At the same time, it has benefited world trade thanks to its generally liberal external trade policy.

The success of EC integration has created dynamics towards greater regional integration both in Europe and elsewhere. In Europe, one of the most interesting recent developments are the European Agreements between the Community on the one hand, and Czechoslovakia, Hungary and Poland on the other. These agreements, which aim at the establishment of a free trade area within 10 years of their entry into force (March 1992), are analysed in Chapter II.B. Elsewhere, there are equally important efforts to create regional economic schemes. In America, efforts are under way for the establishment of a North-American Free Trade Area (Nafta) between the United States, Canada and Mexico. Also, many developing countries are either launching new plans or reviving old schemes for regional integration. Chapter II.C presents a critical review of regional integration among developing countries based on the EC experience.

References

Bhagwati, J. N. (1992), 'The threats to the world trading system', *The world economy*, 15, pp. 443-456.

Hufbauer, G. C. (1990), 'An overview', in: G. C. Hufbauer (ed.), *Europe 1992: An American perspective*, The Brookings Institution, Washington DC.

Jacquemin, A. and Sapir, A. (1988a), 'European integration or world integration?', *Weltwirtschaftliches Archiv*, 124, pp. 127-139.

Jacquemin, A. and Sapir, A. (1988b), 'International trade and integration of the European Community', *European Economic Review*, 32, pp. 1439-1449. Reprinted in Jacquemin, A. and Sapir, A. (eds), *The European internal market: trade and competition*, Oxford University Press, Oxford.

Jacquemin, A. and Sapir, A. (1991), 'Europe post-1992: internal and external liberalization', *American Economic Review*, 81, pp. 166-170.

Lawrence, R. (1991), 'Emerging regional arrangements: building blocks or stumbling blocks?', in: O'Brien, R. (ed.), 'Finance and the international economy', *The Amex Bank Review Prize Essays*, Oxford University Press, Oxford.

Lloyd, P. J. (1992), 'Regionalization and world trade', *OECD economic studies*, 18, pp. 7-34.

Messerlin, P. (1992), 'Trade policies in France', in: Salvatore, D. (ed.), 'National trade policies', *Handbook of comparative economic policies*, Vol. 2, Greenwood Press, New York.

Sapir, A. (1992), 'Regional integration in Europe', *Economic Journal*, 102, pp. 1491-1506.

Summers, L.H. (1991), 'Regionalism and the world trading system', presented at the Federal Reserve Bank of Kansas City, August.

Winters, L. A. (1992), 'The European Community: A case of successful integration?', paper presented at the World Bank and CEPR Conference on New Dimensions in Regional Integration, 2 and 3 April, Washington DC.

II — Regional integration and trade

B — EC trade with Central and Eastern Europe: a new relationship

1. Introduction

The countries of Central and Eastern Europe[1] are undergoing an unprecedented revolution aimed at the transformation of economic policy from central planning to market orientation. One of the crucial elements of this process involves the restructuring of Eastern Europe's foreign economic relations.

Until the change in economic policy, the participation of Central and Eastern Europe and the Soviet Union (EESU) in world trade had a special flavour. The share of EESU in world trade had been steadily declining, reaching 8% in 1988. At the same time, however, the degree of openness (measured by the ratio of exports to GNP) of the individual East European countries was roughly comparable to that of several countries of Western Europe.[2] But the main feature of this trade was its high degree of concentration within the former CMEA zone. In 1988, two-thirds of the exports by the countries of Central and Eastern Europe remained inside the zone. Rather than the result of market forces, trade by these countries was, therefore, mainly a reflection of centrally planned decisions.

There is broad agreement that the success of Central and Eastern Europe in shifting economic policy towards market orientation hinges partly on their ability to become again fully-fledged participants in the world trading network. This agreement stems from the lessons drawn from the experience of the past decades in countries around the world, demonstrating the virtue of market-oriented trade in fostering economic growth. The countries of Central and Eastern Europe share a strong desire to avail themselves of long-denied opportunities to import Western goods and technology in order to improve their economic performance.

Likewise, it is widely recognized that the successful integration of Central and East European countries into the world economy will depend upon two complementary factors: their capacity to transform their own economies and improved access to foreign markets.

The economic transformation of the countries of Central and Eastern Europe raises a number of issues with respect to the volume of trade, its geographical pattern, and its product composition. Most economists expect important changes on all three accounts, but opinions vary on the speed at which changes are likely to take place. One area, however, where adjustments have occurred with great rapidity is the geographical pattern of trade. With the collapse of the CMEA, and the crisis in the Soviet Union, the countries of Central and Eastern Europe have redirected their trade flows to Western industrial economies, particularly the EC.

The issue of access to industrial countries' markets has, therefore, become a matter of great acuity. The EC, which has become the largest trading partner of most countries of Central and Eastern Europe (in 1991 it accounted for about 50% of exports from and imports to Hungary and Poland), has not only taken a number of important steps to improve the access to its markets, but also reshaped its relations with these countries in a fundamental way. The speed and extent of the Community's response has been unprecedented, particularly when taking into account the nature of its decision-making process.

Initially, the Community's response focused largely on unilateral, piecemeal trade measures and on assistance. Gradually, however, the emphasis moved to a more systematic redefinition of its relations with the emerging democracies in Central and Eastern Europe. As a first step towards the eventual full integration of these countries into the Community, a free trade area is now being established. This indicates clearly that, although it continues to provide substantial financial assistance to Central and East European countries (CEECs), the Community views trade as the most important channel for supporting their economic transformation.

Meanwhile, economists in academia and international organizations have taken to task the industrial countries, especially the EC, for their trade policies *vis-à-vis* the countries of Central and Eastern Europe. Industrial countries are often urged to dismantle non-tariff barriers which, according to the OECD Secretariat, 'are particularly restrictive in sectors where CEECs have done relatively well' (OECD, 1991, p. 18). The sectors concerned are agriculture, textiles and clothing, steel and chemicals. 'Of these, the first three are widely subject to restrictive sector-specific arrangements which largely put them outside the GATT agreement. The fourth has been heavily restricted by the application of anti-dumping and countervailing duty actions' (OECD, 1991, p. 19).

---

1 Throughout the paper, the definition 'Central and Eastern Europe' will refer to Bulgaria, Czechoslovakia, Hungary, Poland and Romania. Unless specified differently, Yugoslavia is outside the scope of the paper. When the Soviet Union is included, the expression 'Eastern Europe and the Soviet Union' (EESU) will be used.

2 Estimates of the degree of openness, however, vary substantially across sources mainly due to different GNP and intra-CMEA trade estimates. For instance, Collins and Rodrik (1991) find a ratio of exports to GNP of 19% for Czechoslovakia, 15% for Hungary and 7% for Poland (1988 figures), while the OECD (1991) reports figures of 35, 33 and 19% (1989 figures), respectively.

The years ahead will witness a greater integration of the countries of Central and Eastern Europe with their Western neighbours. A few key indicators on the size of these countries will shed some light on the magnitude of the impact of such integration. In terms of population, the CEECs (96 million inhabitants in 1989) are nearly three times as large as the EFTA group (34 million), but somewhat smaller than the EC's southern neighbours (Turkey and the three Maghreb countries, with a population of 110 million). The picture concerning the relative size of GDP is more complicated. Depending upon the source, the ratio of CEECs' GDP to that of the EFTA ranges between one-third and one. Using World Bank estimates, the GDP of Central and Eastern Europe stood, in 1989, at about USD 200 billion, roughly equivalent to the Netherlands' GDP. This compares with USD 670 billion for the EFTA, and about USD 140 billion for Turkey and the Maghreb combined.

The uncertainty surrounding the GDP figures also affects the estimates of per capita income. According to the World Bank, the per capita GDP of Central and Eastern Europe amounted to about USD 2 000 in 1989. This was less than one-tenth the income per head of EFTA, but more than 50% that of Turkey and the Maghreb combined. However, other socioeconomic indicators, such as those relative to health and education, suggested that CEECs were closer to the EFTA countries than to Turkey and the Maghreb. Turning to external trade, Central and Eastern Europe had, in 1989, merchandise exports of about USD 50 billion, i.e. somewhat less than Spain (USD 66 billion). Although CEECs' exports were nearly double those of Turkey and the Maghreb combined, they amounted to less than one-third those of EFTA.

The purpose of this paper is to examine some of the issues associated with the integration of the countries of Central and Eastern Europe in the world economy, in particular with respect to EC commercial policy. The main argument can be summarized as follows. Section 2 looks at the volume of trade of CEECs, its product composition and its direction. It confirms that the EC has become, and will remain, the main partner of Central and Eastern Europe. Section 3 shows how the Community's commercial policy has been adapted to allow better access to exports from Central and Eastern Europe. Section 4 examines the consequences of EC trade liberalization for exports from Central and Eastern Europe and competing third countries. It addresses the criticisms of EC commercial policy summarized above. Moreover, it attempts to gauge the relative importance of supply factors in Central and Eastern Europe and access conditions in the EC market in shaping trade flows between CEECs and the EC. Section 5 concludes.

2. Volume, composition and direction of trade

There is much speculation in economics literature about the potential consequences of the economic transformation in Central and Eastern Europe for international trade.[1] Most of the literature focuses on the medium term, at the end of Central and Eastern Europe's transition to a market economy. This paper concentrates, instead, on the transition phase.

2.1. Direction of trade

The recent collapse of the Council for Mutual Economic Assistance (CMEA) and the recession in Central and Eastern Europe have led to a dramatic change in the geographical composition of exports from Central and Eastern Europe and the Soviet Union (EESU). Instead of being directed eastwards to their former CMEA partners, exports from EESU are now increasingly shipped westwards, particularly to the EC.

The actual geographical composition of exports from EESU

Table 4 indicates a number of interesting features about the geographical pattern of exports from EESU as it stood in 1989:

(i) On average, 75% of exports from the countries of EESU were shipped to Europe (which is defined here as comprising the EC, EFTA, and EESU). This proportion was, in fact, no different from that observed for the countries of either the EC or EFTA.[2] This proportion varied relatively little among the individual EESU countries (the only outlier was Romania with a ratio of only 58%).

(ii) On average, the share of exports from EESU shipped to other EESU countries was larger than the share going to the EC. This was also true of all the individual EESU countries. Exports to the Soviet Union ranged between 25% of Poland's exports and 58% for Bulgaria (see also Graph 10).

(iii) Within EESU the main market for exports from the EESU countries was, by far, that of the Soviet Union.

[1] See, for instance, CEPR (1990), Collins and Rodrik (1991), and Hamilton and Winters (1991).

[2] In 1989, the share of EC and EFTA goods shipped to Europe was 73 and 76%, respectively.

Table 4

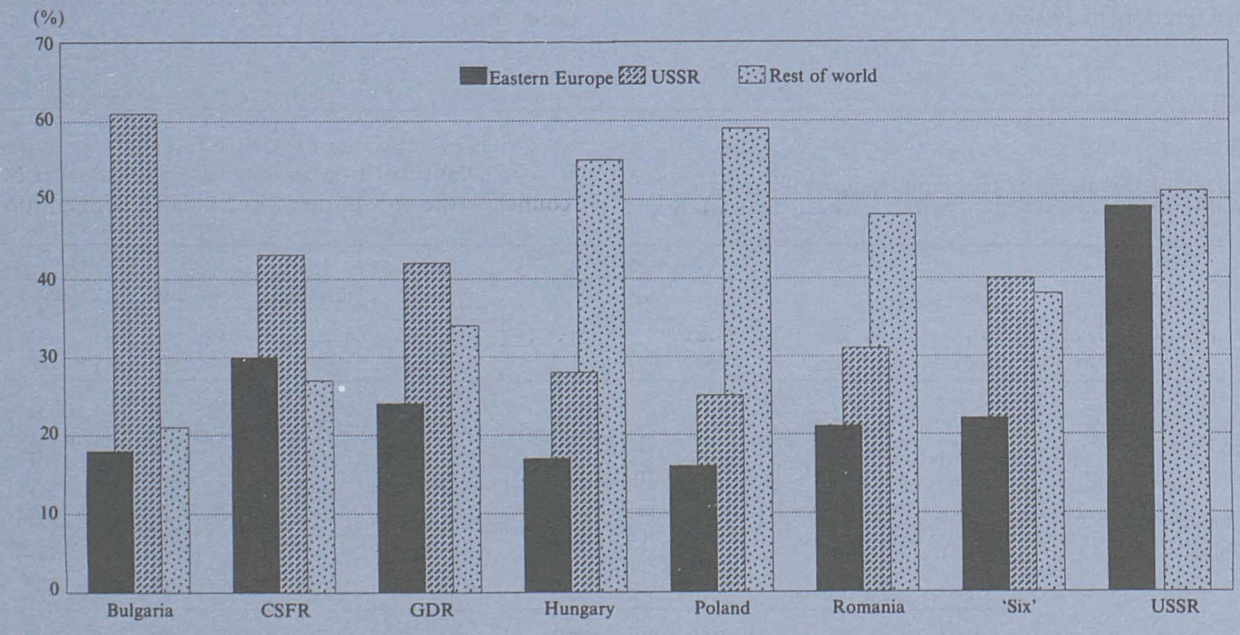
Eastern Europe and the Soviet Union: geographical composition of exports, 1989

(% of exports to the world)

Partner	Bulgaria	Czechoslovakia	Hungary	Poland	Romania	Yugoslavia	Soviet Union	Average
EC	8	16	24	31	18	38	26	24
EFTA	1	5	9	10	1	8	9	6
EESU	75	59	42	39	39	30	33	45
Eastern Europe	(17)	(16)	(14)	(14)	(9)	(10)	(33)	
Soviet Union	(58)	(43)	(28)	(25)	(30)	(20)		
Europe — Total	84	80	75	80	58	76	68	75
World	100	100	100	100	100	100	100	100

Source: Collins and Rodrick (1991).

GRAPH 10: **East European countries and the USSR: distribution of exports in 1988**



Source: Blackhurst, R. (1991).

This corresponds to the fact that the Soviet Union accounted for about two-thirds of EESU's combined GNP.

Drastic changes in the geographical pattern of Central and Eastern Europe's exports have taken place in 1990 and 1991:

(i) The importance of the EC market, which had already increased for some countries in 1988/89, shot up drastically in 1990. Table 6 shows that the EC accounted for more than 30% of exports for each country of Central and Eastern Europe. This proportion was, none the less, still substantially lower than that of other neighbours of the Community.

(ii) In 1991, the importance of the EC market again increased for Central and East European exporters, reaching about 50% for Hungary and Poland.

(iii) Table 5 traces, in greater details, the rapid transformation of the geographical pattern of Poland's exports. During the first three quarters of 1990, the share of Poland's exports going to EESU was down 15 to 16 points compared to the annual figure for 1989. At the same time the share absorbed by the EC was up 12 to 14 points. As a result, the EC became the single largest market for Poland's exports. During the last quarter of 1990 and the first quarter of 1991 these shares changed again: EESU was down a further 10 points and the EC was up an additional 10 points. These figures have remained roughly constant throughout the second and third quarters of 1991.

Finally, note should be made of Graphs 11 and 12 which show that the EC is, within the OECD countries, by far the largest trading partner of Central and Eastern Europe. This was already the case in the past, but its relative importance has further increased since 1989.

The 'normal' geographical composition of exports from CEECs

A number of studies have attempted to compute the 'normal' geographical pattern of trade of Central and Eastern Europe, i.e. the pattern that would prevail if Central and Eastern Europe were a market economy fully integrated into the world system. These studies generally use a 'gravity model' which relates bilateral trade flows to variables such as GNP, population, distance, and trading arrangements. These models show that the existence of the CMEA system drastically increased intra-CMEA flows at the expense of trade with Western countries, particularly the EC.[1] The breakdown of the CMEA should, therefore, result in a redirection of exports towards the EC. In the same spirit, André Sapir has attempted to estimate the 'normal' geographical allocation of Poland's exports using the following two-step procedure.[2]

1 See Havrylyshyn and Pritchett (1991), Collins and Rodrik (1991), and Hamilton and Winters (1991).

2 André Sapir, 'The geographical composition of exports from Eastern Europe and the Soviet Union', internal document, EC Commission, 6 August 1991.

Table 5

Poland: geographical composition of exports, 1989

(% of exports to the world)

Partner	Actual						Predicted	
	1989	1990				1991	Sapir	C & R
		Q1	Q2	Q3	Q4	Q1		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EC	31	43	43	45	55	54	51	51
EFTA	10	:	:	:	:	:	5	10
EESU	39	24	25	24	15	15	24	23
Eastern Europe	(14)	:	:	:	:	:	(7)	(9)
Soviet Union	(25)	:	:	:	:	:	(17)	(14)
Europe — Total	80	:	:	:	:	:	80	85
World	100	100	100	100	100	100	100	100

Sources: columns (1) and (8): Collins and Rodrick (1991); columns (2) to (6): Polish statistics; column (7): own estimates.

Table 6

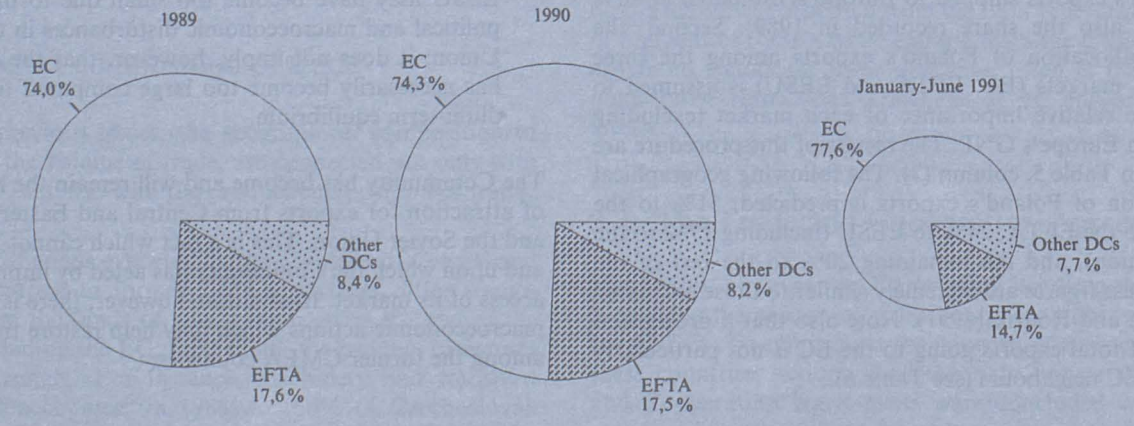
Share of total exports to the EC, selected countries, 1984-91

(%)

	1984	1985	1986	1987	1988	1989	1990	1991
Bulgaria	21,6	17,1	20,1	20,7	17,7	18,7	28,8	37,8
Czechoslovakia	22,8	22,8	23,4	24,4	24,2	25,7	32,0	n.a.
Hungary	16,4	16,0	17,3	19,8	22,5	24,7	33,5	39,7
Poland	23,4	22,6	21,3	25,8	30,3	30,9	35,6	45,0
Romania	26,0	24,1	22,6	25,9	24,0	25,2	31,4	34,2
USSR	40,5	33,6	27,8	29,1	27,9	29,7	38,7	43,0
Austria	55,2	56,1	60,2	63,6	63,8	64,9	64,8	65,8
Finland	38,9	37,1	38,3	42,1	44,2	43,9	46,7	51,2
Greece	54,9	54,3	63,7	66,9	64,4	64,7	64,1	63,7
Portugal	61,9	62,7	68,3	71,8	72,0	72,0	n.a.	n.a.
Spain	51,6	52,1	60,3	63,8	65,7	66,4	72,9	72,1
Turkey	39,0	40,3	43,7	47,8	43,7	46,7	53,3	51,4

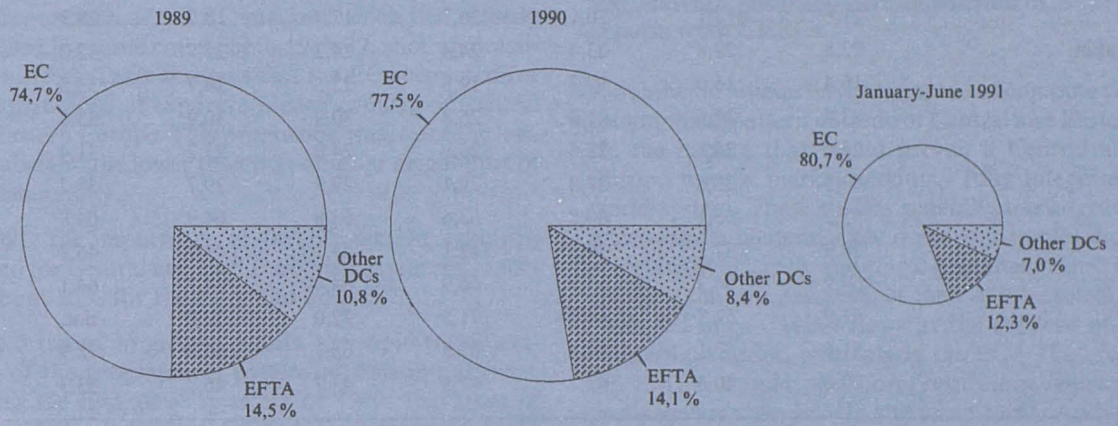
Source: IMF, *Direction of Trade Statistics*, 1991.

GRAPH 11: Trade of Central and Eastern Europe with developed countries (DCs): imports of Central and Eastern Europe



Other DCs = Canada, Japan and the USA.
Source: Commission services.

GRAPH 12: **Trade of Central and Eastern Europe with developed countries (DCs): exports of Central and Eastern Europe**



Other DCs = Canada, Japan and the USA.
Source: Commission services.

First, based on the previous discussion, the 'normal' share of Poland's exports shipped to Europe is estimated at 80% (which is also the share recorded in 1989). Second, the 'normal' allocation of Poland's exports among the three European markets (EC, EFTA and EESU) is assumed to follow the relative importance of each market (excluding Poland) in Europe's GNP. The results of this procedure are reported in Table 5, column (7). The following geographical composition of Poland's exports is predicted: 51% to the EC, 5% to the EFTA, 24% to EESU (including 17% to the Soviet Union), and the remaining 20% to the rest of the world. These figures are extremely similar to those estimated by Collins and Rodrik (1991). Note also that a proportion of 50% of total exports going to the EC is not particularly large for EC neighbours (see Table 6).

Two messages emerge from the comparison between actual and predicted trade flows for Central and Eastern Europe:

(i) the current (1991) geographical trade pattern of CEECs' exports is much closer to the 'normal' pattern than the past (1989) one;

(ii) there may, however, exist an over-shooting: the share of EESU may have become too small due to the current political and macroeconomic disturbances in the Soviet Union; it does not imply, however, that the EC share has necessarily become too large compared to the medium-term equilibrium.

The Community has become and will remain the main pole of attraction for exports from Central and Eastern Europe and the Soviet Union. This is a fact which cannot be eluded and upon which the Community has acted by improving the access of its market. In addition, however, there is room for macroeconomic actions which may help restore trade flows among the former CMEA countries.

2.2. Volume of trade

The issue of the geographical composition of exports from Central and Eastern Europe cannot be entirely separated from the problem of the volume of trade.

The economic transformation in the countries of Central and Eastern Europe can be expected to increase the volume of their exports to the EC for two reasons. The first is the redirection of exports away from the CMEA, which is already on its way. The second is the medium-term effect of economic transformation on trade openness and output.

As far as the first factor is concerned, Brada (1991) has calculated that the elimination of the trade-diverting effect of the CMEA could free about 50% of Central and Eastern Europe's exports. The obvious question that arises is whether the goods diverted from the CMEA could find a market elsewhere. Some elements of answer will have to await the next section, which deals with the product composition of trade.

The second factor is even more uncertain. Estimates of the effect of economic reform on trade openness in Central and Eastern Europe vary a great deal between analysts. To a large extent, differences in predicted values are accounted for by differences in the current values (see footnote 2 on p. 27). None the less, most economists anticipate an increase in total exports as a result of simulations using a 'gravity model'. Based on 1985 trade flows, Hamilton and Winters (1991) anticipate CEECs' exports to increase by 50%, assuming production constant. A similar increase is predicted by Collins and Rodrik on the basis of 1988 trade flows, again assuming production remains constant. If production is allowed to increase, as can be expected in the medium term, exports should rise even further. Most of these additional exports can be expected to flow towards the EC market.

2.3. Product composition of trade

The two previous issues, the geographical composition of trade and the volume of trade, are connected not only with each other, but also with the product composition of trade.

The types of goods exported by the countries of Central and Eastern Europe to former CMEA partners differ significantly from the kinds of goods exported to the rest of the world, including the EC. First of all, the product categories diverge strongly. For instance, machinery and transport equipment accounted, in 1988, for 60% of Czechoslovak exports to CMEA countries, but only for 20% of exports to other countries (they accounted for 14% of exports to the EC). Secondly, even within the same product category, the quality of products is likely to differ according to their destination, the exports to CMEA countries having a lower quality than exports to the EC.

The implication of these differences is that Central and Eastern Europe may not be able to ship to the West many of the goods freed up by a decline in intra-CMEA trade, at least not in the short term. On the other hand, a large proportion of the goods presently exported by the countries of Central and Eastern Europe to the West are regarded there as sensitive products.

Consequently, in order to match the decline in exports to the former CMEA, the expected increase in exports from Central and Eastern Europe to the West can only be met in either (or a combination) of the following two ways: (i) CEECs succeed rapidly in converting part of their production capacity formerly used to export to the East; (ii) CEECs succeed in increasing their exports of sensitive products to the West.

The following two sections discuss how changes in EC commercial policy have contributed toward the restructuring of Central and Eastern Europe's exports.

3. EC trade regimes towards Central and Eastern Europe

3.1. Trade regime before the Trade and Cooperation Agreements

Until the late 1980s, the EC rules on State-trading countries placed Central and East European countries at the bottom of the EC's hierarchy of trade preferences. Only Romania (and Yugoslavia) benefited from the EC's generalized system of preferences (GSP), while exports from the CEECs generally faced significant trade obstacles, often in the form of quantitative restrictions (QRs), set at EC and/or national level.

3.2. The Trade and Cooperation Agreements

Since 1989, however, the Community has been engaged in promoting the process of political and economic reforms in the CEECs. To supplement the network of agreements with these countries, actions were taken to ensure that Trade and Cooperation Agreements were concluded with those countries not yet covered by such agreements, while at the same time redefining their objectives and content.

A number of import quotas were removed by the EC Member States already in 1990, as part of Community's trade concessions. Originally, EC-wide quantitative restrictions

were to be gradually phased out in the case of Hungary and Poland. Subsequently, the extension of Operation Phare to other countries resulted in the elimination or suspension of QRs *vis-à-vis* Central and Eastern Europe. QRs specifically aimed at these countries and operated nationally by Member States were eliminated, whereas non-specific QRs (covering glass, shoes, toys, leather, some machinery, some non-MFA products and some non-ECSC steel products) were suspended until the end of 1991. The generalized system of preferences was granted to all five Central and East European countries.

The Trade and Cooperation Agreements envisaged specific provisions for certain sensitive sectors, which accounted for a substantial part of CEECs' exports (see Table 7). For textiles, the CSFR, Hungary and Poland accepted an interim (not-renewable) arrangement aimed at replacing for a year the existing bilateral arrangements, in view of putting the three countries on a par with other MFA participants.[1] For 1990 and 1991 the agreements provided for quota increases of +13% for Hungary and +23% for Poland, while residual quantitative restrictions by Member States on non-MFA textiles imports from both countries were eliminated in November 1989.

In the case of agriculture, EC trade concessions were more limited. At the end of the last decade, exports of agricultural products accounted for about one quarter of Hungarian and Polish exports and some 8% of exports from the CSFR.

EC import duties for iron and steel (ECSC products) were already low. Simple average EC tariffs are 3,5% for unworked products, 5,6% for semi-manufactures and 5,4% for manufactures. In 1990, imports from Central and Eastern Europe accounted for some 18% of total extra-EC imports of ECSC products. Trade with those countries has been subject to a series of annual arrangements taking the form of voluntary restraint agreements (VRAs), covering also the five Member States' autonomous quotas. Such VRAs in 1990 covered some 87% of sectoral Community imports from Central and Eastern Europe.

In 1991, VRAs were agreed for the last year, in view of the commitments within the framework of the steel trade liberalization arising from the Community's relations with the USA and the expected Multilateral Steel Arrangement (MSA).

For Poland, Hungary and Czechoslovakia, the Protocol of the Cooperation Agreements concerning ECSC products entered into force on 1 December 1991, 1 January 1992 and 1 April 1992 respectively.[2] Consequently, from the outset of 1992 trade in ECSC products was completely liberalized for Poland and Hungary and for Czechoslovakia as from 1 April 1992.

Table 7

Commodity composition of exports to the EC from Poland, Czechoslovakia and Hungary, 1988-90

(% of total)

A — *Poland*	1988	1989	1990
Food and agricultural products	20,0	23,2	21,0
Textiles and clothing	10,6	10,3	11,2
Iron and steel	6,8	8,9	8,9
Total of the three groups	37,4	42,4	41,1
Other products	62,6	57,6	58,9
B — *Czechoslovakia*	1988	1989	1990
Food and agricultural products	7,0	8,6	7,6
Textiles and clothing	10,9	9,9	10,7
Iron and steel	14,0	14,7	15,2
Total of the three groups	32,0	33,1	33,5
Other products	68,0	66,9	66,5
C — *Hungary*	1988	1989	1990
Food and agricultural products	28,5	29,3	23,8
Textiles and clothing	15,8	14,7	15,5
Iron and steel	7,5	7,2	8,3
Total of the three groups	51,8	51,3	47,5
Other products	48,2	48,7	52,5

Source: Eurostat (Comext).

3.3. The Association Agreements (Table 13)

Negotiations for the Association Agreements with the CSFR, Hungary and Poland started in December 1990 and were signed on 16 December 1991. The Agreements, which also contain sections on political dialogue and institutional provisions, aim at the establishment of a free trade area and freedom of movement, as well as at economic and financial cooperation, in view of ever-closer relations with the countries concerned. The free trade area is to be established at the end of a transitional period, of a maximum duration of 10 years, divided into two successive stages of five years

[1] The CSFR, Hungary, Poland and Romania are participants in the Multifibre Arrangement (MFA) governing trade in textiles and clothing. Their combined share was less than 11% of EC imports of textiles and clothing from MFA-restrained countries. In 1990, textiles and clothing accounted for 11,2% of Polish, 10,7% of Czech and 15,5% of Hungarian exports to the Community.

[2] The main commercial effect of these protocols was the suppression of national contingents for five Member States: Belgium, Germany, Italy, Luxembourg and the Netherlands.

each, starting from the entry into force of the Agreements (March 1992). Pending the ratification of the Agreements by the national parliaments, interim agreements are currently in place to implement the provisions of the European Agreements on trade and trade-related matters.[1] Negotiations in view of Association Agreements with Bulgaria and Romania started in mid-May 1992. The trade component of these Agreements is virtually the same as in the case of the CSFR, Hungary and Poland.

On the Community side, the Association Agreements consolidate all the previous unilateral trade concessions, while laying the ground for the complete removal of all trade obstacles by the end of the transitional period. The trade provisions involve the immediate removal of all quotas, while import tariffs will be progressively eliminated over a period ranging between two and five years. The Central European countries will reciprocate more slowly by phasing out tariffs and quotas over a period of four to nine years. As in the previous Trade and Cooperation Agreements, the Association Agreements also contain specific provisions for certain sensitive sectors.

Textiles. The Agreements (Protocol No 1) provide for the progressive elimination of import duties over six years from the date of entry into force of the Agreements. Existing quantitative restrictions are to be eliminated within a period not shorter than five years (but no longer than half the period agreed in the Uruguay Round for the phasing out of the MFA) as from 1 January 1993. Modalities for tariff reduction and phasing out of the QRs are to be negotiated bilaterally. The Agreements contain safeguard provisions in case of market disruption (related to specific EC regions and products), and stipulate that at the end of the 10-year transitional period sectoral trade between these countries and the EC will no longer be subject to special treatment.

Iron and steel (ECSC products). The VRAs system expired at the end of 1991, not having been renegotiated for 1992. The entry into force of the Association Agreements in March 1992 removed the residual national quotas.[2]

Agriculture. In addition to the consolidation of and some improvements to previous concessions (GSP and elimination/suspension of QRs), there will be reciprocal concessions for specific products of particular export interest for Czechoslovakia, Hungary and Poland.

In 1991 about 50% of all exports from the CSFR, Hungary and Poland entered the EC market free of any import duty or quantitative restriction. The proportion of imports that entered duty-free (under either the MFN or GSP regime) was respectively 57% for Poland, 47% for Hungary and 46% for the CSFR.

Other major provisions

In 1991, anti-dumping measures were in force against the CSFR, Hungary and Poland. They were largely concentrated in chemical products, and were mostly in the form of undertakings.[3] Such undertakings were originally agreed with central entities. The application of existing anti-dumping measures, however, has become more problematic with the introduction of market economy principles in those countries, since the new economic agents are not bound by previous undertakings.

The Association Agreements provide for anti-dumping rules in accordance with existing domestic legislation and the GATT Anti-dumping Code. The procedure requires that the Association Council be informed of a dumping case as soon as the authorities of the importing party initiate an investigation. Anti-dumping duties may be adopted when dumping continues or no satisfactory solution is reached (e.g. an undertaking) within 30 days after the matter has been referred to the Council. In addition, provisional measures may be taken where exceptional circumstances require immediate action. Uncertainty prevails, however, as to the legal basis for computing normal values in assessing dumping margins. In the past, specific rules were adopted *vis-à-vis* State-trading countries; under these rules normal values were calculated on the basis of cost structures in relevant third countries. In the future, when transformation towards market economies will be completed, general rules (i.e. those applying in the case of market economies) will be used. During the transition period, special legislation may be necessary.

Furthermore, the Agreements foresee the application of Community provisions in the area of competition policy, in particular State aids. In 1992 the implementing rules were, however, not yet in place. They must be adopted within three years from the entry into force of the Agreements.

---

1 Council Decision of 25 February 1992, OJ L 115/1, 30.4.1992.

2 The elimination of national quotas had been anticipated for Poland and Hungary by the entry into force of the ECSC Protocols of the Cooperation Agreements (1 December 1991 and 1 January 1992). For Czechoslovakia the Protocol of the Cooperation Agreement virtually did not have any effect as it entered into force on 1 April 1992, that is after the entry into force of the Association Agreements.

3 The products subject to anti-dumping measures are the following: silicon carbide (Poland), sodium carbonate (Poland), methenamine (Poland and CSFR), artificial corundum (Poland, CSFR and Hungary), potassium permanganate (CSFR), urea (CSFR and Hungary), and copper sulphate (Poland, CSFR and Hungary). The impending expiry for the last product has already been published. At present investigations have been initiated for silicon carbide (Article 15 review) and seamless steel tubes (new investigation affecting all three countries).

With regard to State aids, during the first five years (which may be extended by an additional five-year period), Czechoslovakia, Hungary and Poland will be treated as the least developed areas within the Community. This implies that they may grant aid for investments for up to 75% of their value and, under certain conditions, also temporary operating aids without breaching the Agreements. If the Community considered a trade-related measure as appropriate, it would first have to report it to the Association Council for consultation, and in any event such a measure would have to be in conformity with the procedures and under the conditions laid down by the GATT.

The Agreements provide for the possibility of safeguard measures in case of serious injury to Community producers, or serious sectoral difficulties leading to a significant deterioration in the economic activity of a Community region. No specific mention is made of the type of appropriate measures, which are normally taken after mutual consultation.

The actual impact of the Agreement provisions aimed at countering potential negative effects of import surges and State aids remains to be seen, and will crucially depend on the way they are implemented.

One of the Protocols of the Association Agreements lays down the arrangements applicable in terms of rules of origin. To benefit from the trade preferential treatment stemming from the Agreements, goods exported to the Community must have been fully produced or undergone sufficient working or processing in one of the three CEECs. The Agreements also allow for cumulation: those products that have not undergone sufficient working or processing in one of the three countries, but previously originated from either the Community or one of the other two countries, also qualify for preferential treatment.[1] Broadly speaking, in this area the three CEECs enjoy a treatment similar to that of the EFTA countries before the creation of the EEA.

3.4. Compatibility with GATT of Association Agreements: bilateral versus multilateral

As recent developments show, the countries of Central and Eastern Europe cannot look to intra-regional trade to cushion the process of integration of their production structures into the world economy. Even smaller regional integration schemes in Central and Eastern Europe, perhaps more acceptable at the political level, would hardly give the needed boost to their restructuring economies. By the same token, larger trade concessions with developing countries would fall short of making a major impact. And certainly the last thing these restructuring economies need is the replacement of their old centrally-planned price structures with a new one relying on inward-looking policies based on import substitution. This makes a durable acceleration of expansion of trade with the rest of the world, and in particular with their closer continental markets, yet more pressing.

Most CEECs have regularized their position in international organizations. All are, or are in the process of becoming, members of the IMF and the World Bank. With the exception of Albania, Bulgaria and the Soviet Union, all are Contracting Parties to the GATT.[2]

The creation of a free trade area, as envisaged in the Association Agreements, is fully compatible with the multilateral trading system as long as it complies with the two main conditions set in Article XXIV of the GATT. The GATT allows the formation of free trade areas or customs unions which, without raising trade barriers against third countries, provide its members with preferential treatment, as in the case of the Community itself or the US-Canada FTA. The presumption behind the acceptance of these forms of agreement has been that their trade-creating effects are larger than their trade-diverting ones. In addition, GATT Article XXIV requires that preferential agreements cover 'substantially all trade', which has generally been interpreted as meaning about 80% of merchandise trade, rather than being limited to a small number of sectors.

As far as the Community is concerned, it already has one of the lowest (bound) tariff structures. In some sectors, however, the level of protection is relatively higher, due to the presence of non-tariff measures. It is in these sectors (textiles and clothing, agriculture, ECSC products) that the risk of trade diversion may become real. In the case of textiles and clothing, however, the explicit link made by the Agreements with the Uruguay Round reduces the likelihood of such an outcome.

On the other hand, countries in Central and Eastern Europe also have a low level of external protection, having eliminated most of the non-tariff barriers of central planning, and

[1] As a general rule, non-originating materials are considered to be sufficiently worked or processed when the product obtained is classified in a heading (of the Harmonized System) which is different from that in which all the non-originating materials used in its manufacture are classified. In addition, the Protocol concerning rules of origin contains a list of products for which specific conditions (e.g. a percentage rule) must be fulfilled to obtain the originating status.

[2] The CSFR and Yugoslavia acceded to GATT as market economies; Hungary, Poland and Romania under special provisions; Bulgaria, an observer to GATT since 1967, applied to accede to GATT in 1986. Hungary and Poland are in the process of renegotiating their Protocols of Accession.

having long had relatively low tariffs.[1] The sustainability of such an open trade regime during the difficult phase of transformation of their economies may, however, be questioned.

4. Impact of EC trade liberalization on Central and Eastern Europe

4.1. Supply response in Central and Eastern Europe

In view of closer trade relations with the Community, CEECs will have to face not only an adaptation to the EC requirements, but also, and more importantly, the building up of a market-based economy to be integrated into the world economy. The disappearance of the CMEA system (formally in April 1991, but much earlier in practice) translated into the vanishing of well-established pricing formulas and clearing facilities associated with the traditional CMEA transferable rouble trade and payment arrangements. Although the CEECs have proved rather successful in reorientating their trade towards more promising markets in Western Europe, the economic situation in Central and Eastern Europe continues to deteriorate, with the sharp reductions in output and domestic demand observed in 1989/90 expected to continue, or at best stabilize, in 1992/93.[2]

The breakdown of trade links within the CMEA block has not only led to the loss of previously secured market outlets but, given the rigid division of labour among former CMEA countries, also to potential supply bottlenecks which can hinder the development of domestic production. Though reforming countries can now supply their economies in the more efficient world markets, such a possibility is also limited by the availability of hard currency. Considerable drops in investment are delaying the capacity of CEECs' economies to react swiftly to market signals. The uncertainties surrounding the issue of private ownership means that there is little incentive for would-be private investors to take investment decisions in substitution of the previously centrally-planned ones. Several observers have stressed (see Van Brabant, 1991) the enormous difficulties in moving from the legacy of 40 years of central planning to a fully-fledged market economy: lack of familiarity with how markets actually operate; the absence of a broad middle class that could take over management from political or administrative decision-makers; the weakness of a managerial and entrepreneurial culture; expectations of individuals as to the preservation of most of the benefits granted under communism; the absence of institutions, legal bases and the financial infrastructure necessary for a market economy. Progress in these areas varies considerably among the countries of Central and Eastern Europe, and is far from proceeding swiftly as it meets significant internal resistance.

The transformation process in CEECs will require substantial capital equipment, which developed countries, especially those in Europe, will be most likely to supply. CEECs' relatively cheap (see Table 8) and supposedly well-trained labour resources are also likely to attract investment from developed countries. In the longer term, if such a process succeeds, it would lead to relatively quick changes in wage and income levels in CEECs, pushing their specialization pattern towards skill-intensive, higher-cost goods.

Table 8

Hourly earnings in manufacturing

(1990 USA = 100)

USA	100
Germany	138
France	98
Japan	82
Spain	72
Portugal	20
South Korea	24
Taiwan	24
Singapore	19
Mexico	12
Poland	6

Source: Blanchard, Dornbusch et al. *Reform in Eastern Europe*, MIT Press, 1991.

The ability to increase exports in the face of large import-intensive investment requirements is crucial if external viability is not to be undermined by unsustainable levels of external debt. The export base of CEECs, for the time being, is likely to be rather limited and concentrated on existing productions, largely those in so-called 'sensitive' sectors. Their potential export capacity for the near future is unlikely to increase massively, and will probably rely mainly on comparatively cheap labour. Outward-oriented policies would be more likely to be adopted as a guide to their

[1] In 1990/91, the CSFR and Poland implemented trade reforms which reduced tariffs by at least 40 percentage points, and eliminated almost all peaks from their tariff schedules, while at the same time abolishing all quantitative restrictions on imports other than those based on health and public safety. A long-standing member of GATT like Czechoslovakia now has a low 'bound' tariff average of 4 to 5%.

[2] See OECD, 'Integrating Central and East European countries in the international economy', WP3(91)5, p. 4.

transformation process into a market economy by a buoyant external environment. While the old trading relationships have dissolved faster than anticipated, integration into the world trading system remains time-consuming. The 'early harvest' that followed removal of disincentive to market-orientated trade, particularly in those sectors where CEECs already had a significant production capacity in place, is probably tapering off. Further export growth, consequently, must rely on restructuring of production, including the ability to respond flexibly to emerging and changing demand stimuli.

The policy implication for their major trade partners, as acknowledged by all OECD members, is that 'open access to their markets is the single most important contribution that OECD countries can make to improving prospects for transition in the region'.[1]

Even when assuming that the external conditions were fully met, evidence on the actual pace of reform in CEECs arouses a certain apprehension as to the actual progress made thus far. Thus, for example, difficulties in the implementation of institutional changes, great divisiveness and political stalemate appear to inhibit the amplitude of the transformation process in Poland. Likewise, the significant progress made in terms of economic reform and macroeconomic stabilization in Czechoslovakia is increasingly overshadowed by uncertainties related to the future of the federation. There are, however, some signs that a certain degree of supply response is taking place.

4.2. Supply response: the impact of the GSP

Since January 1990, exports from Poland and Hungary to the Community are covered by the generalized system of preferences (GSP), which provides duty-free access for manufactured goods and reduced tariffs for agricultural goods. This section attempts a first evaluation of the impact of the GSP on exports from Poland and Hungary. The purpose is to gauge the supply response of these countries to improved EC market access.

Table 9 below gives the basic information on EC imports from Poland and Hungary in 1990 and 1991, by tariff regime.

The most striking feature is that only 35% of dutiable imports from Poland and Hungary (i.e. imports of products for which the common external tariff is not nil) actually benefited from the GSP in 1990. Tables 10 and 11 provide additional information on EC imports of GSP-eligible products from Poland and Hungary. Several elements are worth noting:

(i) Sensitive products, including agriculture and textiles (but excluding ECSC products), account for about half of these countries' exports of GSP-eligible products.

(ii) The rate of utilization of the GSP differs substantially between sensitive and non-sensitive products. It is more than 50% for the latter, but barely 35% for the former (for textile products the rate is only 10%). This difference is accounted for by the GSP regime. Sensitive products (including most textile and agricultural items) are granted duty-free access (or reduced duties for agricultural products) up to a certain limit. No such limit applies to non-sensitive products.

(iii) The fact that even for non-sensitive products the rate of utilization is relatively low is largely due to the (probably temporary) inability of Poland and Hungary to meet the EC's rules of origin.

The picture that emerges from the previous account is that the GSP has improved the access of Poland and Hungary to the EC market, but only to a limited degree due to limitations in the functioning of the system.

[1] Conclusions of OECD WP1 autumn discussion on 'Transition issues in Central and Eastern Europe', 3 and 4 October 1991 (ESD/CPE(91)14, p. 4).

Table 9

EC imports from Poland and Hungary, 1990-91

	Poland				Hungary			
	Million ECU 1990	%	Million ECU 1991	%	Million ECU 1990	%	Million ECU 1991	%
Total	5 156		6 212		2 934		3 624	
Dutiable	4 047	100	4 858	100	2 601	100	3 220	100
GSP-eligible	2 971	73	3 901	80	2 069	80	2 667	83
GSP-granted	1 377	34	2 280	47	903	35	1 325	41

Table 10

EC imports of GSP-eligible products from Poland, 1990

Product category	GSP imports (million ECU)		Utilization (%)
	Eligible	Granted	
Grand total	2 971	1 337	46
Sensitive products, except agriculture and textiles	553	239	43
Sensitive industrial products, petroleum products only	72	12	16
Sensitive industrial products, except petroleum products	480	227	47
Sensitive ECSC products	0	0	
Non-sensitive products, except agriculture and textiles	1 438	845	58
Non-sensitive industrial products, petroleum products only	12	10	77
Non-sensitive industrial products, except petroleum products	1 425	835	58
Non-sensitive ECSC products	0	0	
Textile products	588	63	10
MFA products	555	53	9
Non-MFA products	33	10	31
Agricultural products, with limitations	1	0	0
Agricultural products	389	228	58
Agricultural products, under CAP	56	30	53
Agricultural products, without limitations	332	198	59

Table 11

EC imports of GSP-eligible products from Hungary, 1990

Product category	GSP imports (million ECU)		Utilization (%)
	Eligible	Granted	
Grand total	2 069	903	43
Sensitive products, except agriculture and textiles	402	204	50
Sensitive industrial products, petroleum products only	62	58	93
Sensitive industrial products, except petroleum products	357	145	40
Sensitive ECSC products	0	0	
Non-sensitive products, except agriculture and textiles	937	507	54
Non-sensitive industrial products, petroleum products only	18	12	64
Non-sensitive industrial products, except petroleum products	918	494	53
Non-sensitive ECSC products	0	0	
Textile products	452	49	11
MFA products	428	43	10
Non-MFA products	23	6	28
Agricultural products, with limitations	3	0	1
Agricultural products	273	142	52
Agricultural products, under CAP	73	39	53
Agricultural products, without limitations	199	102	51

Figures for 1991 show significant improvements in the access obtained by the CEECs under the GSP. The share of dutiable imports actually benefiting from the GSP has increased to 47% from 34% in 1990 for Poland, and to 41% from 35% for Hungary. This suggests that these countries have been able to exploit relatively rapidly the opportunities offered by the system. In the case of the CSFR, which only became eligible for GSP treatment in January 1991, and hence had less time to learn the functioning of the system, a lower (yet significant) 38% of exports actually entered the EC market duty-free under the GSP system. In addition, it should be stressed that by far the most dynamic component of Polish and Hungarian exports to the EC are those products which have actually received GSP treatment. For instance, for Poland, GSP-granted exports have grown by 66% between 1990 and 1991, while total exports have 'only' risen by 20%.

The next question concerns the supply response of Poland and Hungary to the improved access to the EC market. In order to examine this issue, the top 10 products (defined in value terms at the GSP tariff line) which have actually benefited from the GSP in 1990 have been selected. These 10 products represent 32% of the total GSP-granted imports from Poland and 26% of the equivalent imports from Hungary. Total imports of these products from Poland and Hungary (i.e. regardless of their GSP treatment) have been examined for the period 1988-90 and compared with total imports of all products from these two countries.

In 1990, the grand total of EC imports from Poland was 34% greater than in 1989 and 53% larger than in 1988. Seven of the top 10 GSP products recorded faster growth than the grand total. Some of these products recorded re-

markable growth, in particular certain iron and steel products (+107% in 1990 compared to 1989) and wooden boxes (+457%). On the other end of the spectrum, the product with the lowest growth (a decline in 1990 compared to both 1989 and 1988) among the top 10 was the automobile, a sensitive product subject to a tariff quota only partially filled in 1990. Imports from Hungary have increased less rapidly than imports from Poland. In 1990, the grand total was only 13% greater than in 1989 and 36% larger than in 1988. Six of the top 10 GSP products had faster growth than the grand total, some of them with remarkable growth, especially sausages (+75% in 1990 compared to 1989).

It would seem, therefore, that Poland and, to a lesser extent, Hungary have both been able to take advantage of the new opportunities provided by the GSP. This suggests that their supply response may not be as low as anticipated. This is also confirmed by the 1991 export growth figures for 1991 reported above.

On the other hand, evidence from the iron and steel sector (whose products are outside the GSP system) suggests that the potential for a sustained export surge from these countries is probably limited.[1] Certain industry analysts are indeed of the opinion that large parts of production in this sector are either uncompetitive and/or of insufficient quality standards to make sustained inroads into the EC market.

4.3. Some longer-term aspects of economic reform in CEECs

Most of the above discussion has concentrated on the short-term aspects of the economic reform process in Central and Eastern Europe. The question remains open as to the longer-term aspects of economic transformation. In this regard, different scenarios can be envisaged. One of the most optimistic, though not necessarily one of the most likely, would entail a rapid export-led economic take-off as in the case of the newly industrializing countries in South-East Asia. Their overall experiences, as well as that of individual developing countries, point to both a high degree of concentration of specific destinations for, and of concentration of specific products in the total exports of individual developing countries.[2]

In addition to the access to large export markets, substantial changes in product composition of their exports have been another key feature of the success stories among the dynamic Asian economies. These changes have been determined, to a large extent, by shifts of production towards new product areas where demand in the developed economies was increasing fastest. Indeed, most of the success of these economies has stemmed from the flexibility in adjusting their structure of production as well as their marketing strategies to changing conditions.

In the case of a successful long-term scenario, Central and East European countries are likely to face internal as well as external frictions. While liberalization brings along overall net benefits, these are the result of efficiency gains and adjustment costs that tend to be unevenly distributed. Adjustment costs can be regarded as the necessary condition for fostering change in a dynamic economy, since they make possible the reallocation of resources across industries. This latter process implies that adjustment costs tend to be sector and/or region specific. Resistance to restructuring is likely to be stronger the more concentrated the effects of trade liberalization and the slower the rate of expansion of expanding industries, both of which have the effect of slowing the absorption of displaced factors.

The more successful the Central and East European countries are in rapidly restructuring their economies, the more trade frictions are likely to arise. The precise impact of a rapid take-off scenario on their main trade partners is difficult to gauge, but a comparison with the four 'tigers' in East Asia provides a useful illustration of the extreme trade effects in case of 'success'. Czechoslovakia, Hungary and Poland taken together are in fact very similar, in terms of population and world trade shares, to the corresponding situation of the four 'tigers' in 1970, before their economic take-off which led to a four-fold increase in their combined export share (see Table 12). The past experience of the four East Asian countries suggests that, despite growing concerns, the world economy can accommodate relatively easily market-share shifts of such an order of magnitude. However, given the scale of the necessary economic restructuring, it seems unlikely that export expansion in CEECs, even under the most extreme scenario, would keep the same pace as the dynamic Asian economies. It therefore seems reasonable to

[1] Out of five Central and East European countries, only Poland appears to have been somewhat constrained by EC quantitative restrictions in this sector (with a 98% degree of quota utilization), while for the CSFR (84%), Hungary (72%), Bulgaria (59%) and Romania (41%) limited access to the EC market does not seem to have been the main obstacle to export expansion. Figures for the first six months of 1991 show that only Poland has been able to take full advantage of the quota increases (with a 106% degree of quota utilization) while the performance of the remaining countries lags even behind those for the corresponding period of 1990.

[2] See Sampson, G.P. (1988), 'Structural change: accommodating imports from developing countries'. The countries surveyed by the study are: Argentina, Brazil, Hong Kong, India, South Korea, Malaysia, Mexico, Taiwan, Yugoslavia, China and Singapore.

expect that, even if fully achieved, their potential gains in export market shares would not pose major difficulties for their closer trade partners.

Table 12

Czechoslovakia, Hungary, Poland and the East Asian 'tigers'

	CSFR, Hungary, Poland	Hong Kong, Singapore, South Korea, Taiwan		
	1988	1970	1980	1990
Population (million)	64,7	52,5	63,2	71,2
Share (%) in world:				
Exports	1,4	2,0	3,8	7,7
Imports	1,2	2,7	4,2	7,4

[1] Adapted from a paper by R. Blackhurst for the Kiel Institute, 'Implications of the changes in Eastern Europe for the world economy', *The Economist*, 6.7.1991.

5. Conclusions

The Community has pursued the objective of providing Central and East European countries with the same preferential treatment as that already granted to its other European neighbours, EFTA and the Mediterranean countries, although there is no reciprocity in the case of the latter. As soon as political changes occurred in the former centrally-planned economies, the Community took steps to open up its market. The first step was the unilateral decision to grant its general system of preferences (GSP) treatment and remove or suspend a number of quantitative restrictions. The second involved extending Trade and Cooperation Agreements to those countries not yet covered by such agreements. Finally, in December 1991, Association Agreements were signed with the Czech and Slovak Federal Republic, Hungary and Poland. These agreements, which entered into force in March 1992, aim at the establishment of a free trade area, and also contain sections on political dialogue and institutional provisions, as well as on economic and financial cooperation, in view of ever-closer relations between these countries and the European Community. The free trade area is to be established at the end of a transition period, of a maximum duration of 10 years, divided into two successive stages of five years each, starting from the entry into force of the agreement.

The Association Agreements offer a substantial improvement in terms of access to the Community market. The general principle is that, from the date of entry into force of the agreement, free access is granted to imports from the CSFR, Hungary and Poland, though certain sensitive products are subject to specific transitional arrangements. After five years all non-agricultural goods will have completely free access to the Community market: all import duties and quantitative restrictions will have been eliminated.

It is important to note that even in sensitive sectors, like textiles, iron and steel, and agriculture the Community has proved ready to take bold steps towards liberalization of access to its market despite strong internal political resistance. As far as textiles is concerned, the Community will completely eliminate all tariffs and quantitative restrictions on imports from the CSFR, Hungary and Poland in five years or half the duration of the period agreed in the Uruguay Round for the phasing out of the Multifibre Arrangement (MFA), whichever is longer. It is important to note that this explicit link between the Uruguay Round and the Agreements ensures that liberalization *vis-à-vis* Central and Eastern Europe will not be done at the expense of other trade partners, as some had feared.

In the case of iron and steel products the situation for the three associated countries is even better than for textiles. The Agreement provides for the complete removal of all quantitative restrictions from its entry into force and the elimination of all import duties within six years. Although the Agreement does not envisage complete liberalization for agricultural products, it does none the less provide improved access to exports from Central and Eastern Europe in terms of both larger quantities and smaller import duties. Whether the Community's concessions in this area, perceived as being of crucial importance by the CEECs, will be sufficient to meet the demands of the latter remains to be seen.

By ensuring access to the EC, the world's largest market, the Association Agreements provide an important element of stability for both domestic and foreign firms to invest in the associated countries. This represents a crucial condition for the transformation process to take place. There is some evidence of positive supply response in Central and East European countries to improved access to the Community market. But much remains to be done by these countries to take full advantage of the new opportunities available. If and when exports from Central and Eastern Europe to the Community will rise significantly, there might be pressure by some affected sectors to limit again these countries' access to the EC market.

In addition to improved market access, it is important to recall that the Community is contributing to the development of these countries by actively participating in the internal process of restructuring towards a market economy, through its own assistance programmes and the coordination

of the G-24 actions, including medium-term assistance to help macroeconomic stabilization and to cushion the adverse macroeconomic impact on the restructuring itself.

In conclusion, by providing a stable environment for trade expansion, the EC is encouraging foreign private investors to build production capacities, contributing to the development of these countries through the transfer of skills and technologies. Financial assistance is playing a complementary role, by providing resources, both human and physical, and by easing in the short to medium term the macroeconomic constraints faced by these countries.

Table 13

The Community's trade regimes towards Central and East European countries (CEECs)[1]

Product/ Trade regime	General	GSP	Agriculture	Textiles & clothing	ECSC products
Before the 'new' trade and commercial and economic Agreements	Imports subject to specific QRs (quotas specifically aimed at EC and operated nationally by Member States) and non-specific QRs (covering glass, shoes, toys, leather, some machinery, some non-MFA products and some non-ECSC steel products) *Romania:* in 1980 first agreement for industrial products	*Romania:* GSP since 1974	Bilateral arrangements since 1976 (meat)	Since 1976 bilateral arrangements. The latter contain provisions on OP traffic: OP quotas established in addition to normal quotas. OP of MFA and non-MFA clothing with Bulgaria, Romania and CSFR subject to unilateral import quotas *CSFR, Hungary, Poland:* VERs under MFA IV *Bulgaria* (not participating in the MFA): VERs for MFA products AD measures: acrylic fibres and synthetic fibres of polyester (Romania)	*Bulgaria, CSFR, Hungary, Romania & Poland:* since 1978 bilateral arrangements (VRAs) Imports from EC also subject to autonomous quotas in 5 Member States (B, D, I, L & NL)
Trade and commercial and economic Cooperation Agreements (CAs) (they focus on trade in industrial products, excluding ECSC products and textiles)	After German unification, GATT waiver, expiring end-1991, for imports into former DDR of agreed duty-free (incl. AD) quantities from traditional EC suppliers CAs: Entry into force: Dec. 1988 (Hungary), Dec. 1989 (Poland), Nov. 1990 (CSFR), Jan. 1991 (Bulgaria) and May 1991 (Romania). Removal of specific QRs and suspension of non-specific QRs: Jan. 1990 (Hungary & Poland), Oct. 1990 (CSFR), Jan. 1991 (Bulgaria) and May 1991 (Romania)	*Hungary & Poland:* Jan. 1990 *CSFR:* Jan. 1991 *Bulgaria:* Jan. 1991 *Romania:* improved GSP as from Jan. 1991	Variable levies applicable also to EC's 'waiver' exports to former DDR (except for beef & live animals)	*CSFR, Hungary, Poland:* for 1990 and 1991 new protocols to CAs providing for quota increases (+13% for Hungary; +23% for Poland) Residual QRs of MS on non-MFA textiles imports from both countries eliminated in Nov. 1989. OPT quotas for Hungary and Poland suspended for 1990. New agreements contain 'price clauses'	In 1990 and 1991 VRAs were still in force for Bulgaria, CSFR, Hungary, Poland and Romania (also covering autonomous quotas) Polish and Hungarian Cooperation Protocols on ECSC products were put into effect from December 1991 and January 1992

Product/ Trade regime	General (excl. sensitive sectors)	AD, State aids, safeguards, rules of origin	Agriculture	Textiles & clothing	ECSC products
'Europe Agreements': CSFR, Poland & Hungary	Agreements signed on 16 Dec. 1991; entry into force on 1 March 1992. Consolidation of all unilateral trade consessions. Establishment of a free trade area at the end of a transition period of maximum 10 years divided into two successive stages of 5 years. Before end of first stage, decision on transition to second stage to be made Tariffs: (a) 'base products' (Annex IIa of Agreement): import duties eliminated after one year; (b) certain metal base products (Annex IIb): progressive reduction (by 20% of the MFN duty per year) and elimination by the end of fourth year; (c) some 'sensitive' products (Annex III): suspension of import duties within the limits of (increasing) annual tariff quotas/ceilings: import duties on quantities in excess of quotas progressively reduced (by 10-15% per year). All duties completely abolished by the end of fifth year QRs: abolished on the date of entry into force of the Agreement. No new import or export duties or discriminatory fiscal charges Specific provisions on phasing out of tariffs and QRs for trade with Spain and Portugal (Protocol 5)	AD: State-trading country legislation no longer applicable. *Ad hoc* legislation likely to be adopted during the transition period State aids: application of existing EC legislation, but implementation rules (in the area of competition policy) to be established within 3 years. During first 5 years, same treatment as the least developed areas within EC Safeguards: measures can be taken, on a bilateral basis, in case of: (a) serious injury to EC products or (b) serious sectoral disturbances or difficulties leading to serious economic deterioration in a Community region Rules of origin: same treatment as EFTA countries (before EEA). Cumulation possible for products made in the EC or one of the other two countries	CAP products: products in Annex VIII will benefit from reductions of customs duties and levies within tariff quotas/ ceilings. QRs related to Council Reg. 3420/83 abolished at date of entry into force. Quantities within tariff quotas will increase by 10% per year (compared to 1990) for each of the first 5 years after entry into force. Tariffs progressively reduced until elimination (in most cases within 1 year). The variable levies reduced by 60% (30% for certain products) by 1994, in three steps of 20%-10% each; these reductions applied only to quantities within quota. For quantities above the tariff quota the variable levy will apply. Minimum import price arrangements for certain products (e.g. soft fruits). Beef: 20% annual reduction on import duties and levies over next 3 years, and 10% annual increase in reduced-rate imports over 5 years. Provisions concerning 'triangular' operations, safeguards and sanitary measures. Protocol No 3 lays down trade concessions (abolition/reduction in customs duties and levies) for non-CAP products (processed goods)	(Protocol No 1 of Agreement): progressive elimination of import duties over six years from date of entry into force QRs eliminated within a period not shorter than 5 years (but no longer than half the period agreed in the Uruguay Round for the phasing out of the MFA) as from 1.1.1993. Modalities for phasing out of QRs to be negotiated bilaterally Import duties and QRs on OPT eliminated since 1 March 1992	(Protocol No 2 of Agreement): Iron & steel: progressive reductions of import duties until elimination over 6 years from date of entry into force. As from March 1992 removal of all remaining national quotas Coal: progressive reduction of import duties over 6 years. After 1 year removal of all QRs, except for exports to the FRG and Spain (informal agreement). After 4 years also the latter will be eliminated

Product/ Trade regime	General (excl. sensitive sectors)	AD, State aids, safeguards, rules of origin	Agriculture	Textiles & clothing	ECSC products
'Europe Agreements': Bulgaria & Romania	Negotiations started in mid-May 1992, expected to be completed by end of the year. Trade provisions as for the previous three countries	As for the CSFR, Hungary and Poland	Similar to CSFR, Hungary and Poland	Similar to CSFR, Hungary and Poland	Similar to CSFR, Hungary and Poland, but negotiating mandate requires for the possibility of stronger safeguard provisions in the case of steel imports

[1] Bulgaria, CSFR, Hungary, Poland and Romania. *Abbreviations:* CA(s) = (Trade and commercial and economic) Cooperation Agreement(s); OP(T) = outward processing (traffic); MS = Member States (of the EC); AD = anti-dumping (measures); ECSC = European Coal and Steel Community; MFA = Multifibre Arrangement; QR(s) = quantitative restriction(s); VER(s) = voluntary export restraint(s); VRA(s) = voluntary restraint agreement(s).

References

Blackhurst, R. (1991), 'Implications of the changes in Eastern Europe for the world economy', to be published in *The transformation of socialist economies*, edited by H. Siebert, Institut für Weltwirtschaft, Kiel.

Brada, J. C. (1991), 'Integrating Eastern Europe and the Soviet Union into the world economy', in: Baldwin, R. E. and Richardson, J. D. (eds), *The Uruguay Round and beyond: problems and prospects*, NBER Conference Report, Cambridge, MA.

CEPR (1990), *Monitoring European integration — The impact of Eastern Europe*, CEPR, London.

Collins, S. M. and Rodrik, D. (1991), *Eastern Europe and the Soviet Union in the world economy*, Institute for International Economics, Washington, DC.

Hamilton, C. and Winters, L. A. (1991), 'Opening up international trade in Eastern Europe', paper presented at CEPR's Economic Policy Panel held in Prague, 17 to 19 October 1991.

Havrylyshyn, O. and Pritchett, L. (1991), 'Directions of trade after transition in Eastern Europe: predictions from a gravity model', World Bank, mimeo.

IMF (1991), 'The world trade system: developments and issues', Document SM/91/196.

OECD (1991), 'Integrating Central and East European countries in the international economy', Document ESD/CPE/WP3(91)5.

Van Brabant, Jozef M. (1991), '1992, the revolution in Eastern Europe and relations among East, South and North', paper presented at the UN Symposium on the implications of the single market act for non-member countries, held in Geneva, 27 to 31 May 1991.

[redacted]

[redacted]

CEPR (1990), Monitoring European

Collins, S. M. and Rodrik, L.
Soviet Union in the world
Economics, Washington

[redacted]

countries in the international economy', E
CPE\WP3\91\5.

paper presented at the UN Symposium

to 31 May 19

II — Regional integration and trade

C — Regional integration initiatives among developing countries: their nature, past performance and current challenges

1. The European Community's support for regional initiatives among developing countries

A subject frequently mentioned in the final communiqué of the June 1992 meeting of Heads of State or Government of the Member States of the European Community (EC) at the Lisbon Summit as regards the EC's external policies was 'regional integration'. Thus,

(i) indicating that 'particular account will be taken of relations ... which have been established with regional and other groupings', when speaking about Latin America, the European Council 'stressed the importance of supporting the efforts of economic integration which are developed at the regional level';

(ii) when speaking about the Maghreb, the European Council selected the '[support for] the current moves towards regional integration' as one of the five priority areas for Community policy towards the region. The support for 'moves towards regional integration' in the Middle East was likewise selected as one of the five priority domains for Community action;

(iii) when speaking about Central and Eastern Europe, the European Council declared its will to 'contribute to the creation of ... frameworks that encourage regional cooperation or moves towards regional or subregional integration'.

All of this evidence provides a rather clear indication of the importance attached nowadays by the Community to this policy matter. Still, this Community interest, while increased by both current events and the ongoing revival of older developing countries' regional initiatives, is not new.

In fact, in its dealings with developing countries, the Community has traditionally favoured regional policy approaches (notably with the ACP States and the Mediterranean countries) and has supported these countries' efforts towards cooperation and integration (most notably, those in Africa and Latin America).

Thus, the Second Yaoundé Convention (the predecessor to the Lomé Convention), signed in 1969, already established that regional organizations of 'associated States' (as the non-EC signatories of this Convention were then known) could be beneficiaries of Community aid. The Convention also granted special preferences to those African regional enterprises bidding for EC-financed development contracts. Finally, it contemplated the possibility of the EC offering lower than MFN (most-favoured nation) import duties on Community imports from regional groupings of associated African States with similar levels of development.

With the definition of a 'global' Community development policy in the early 1970s, the support for regional integration became one of the pillars of that policy. Thus, the 1971 development policy memorandum sent by the Commission to the Council considered the idea of using the 'degree of commitment' to regional cooperation as one of the standards to determine the allocation of development funds to beneficiary countries. Although this idea was never formally carried out, the special meeting of the Development Council of April 1974 adopted for the first time a resolution on regional integration among developing countries in which the Community expressed its willingness to respond favourably to development aid requests from countries engaged in regional cooperation and regional integration efforts.

Since then the support for regional integration and cooperation has been a cornerstone of Community development policy, particularly in the cases of those counties and zones (mostly Africa and Latin America) that have shown an interest in receiving part of their technical and financial assistance in the form of support for regional institutions and projects. Until recently, this support has been less significant in those other zones (such as Asia and the Mediterranean) where this interest was less evident.

In the redesign of Community development policies that has taken place at the turn of this decade, regional integration has continued to play a major role and, in some cases, its support by the Community has become more explicit by earmarking, for the first time, some funds exclusively for regional projects (as is the case in the Lomé IV Convention and in the new Mediterranean policy). In these cases, as well as with the new guidelines for Community cooperation with Latin America and Asia, regional integration has been singled out as a priority issue in the provision of economic cooperation and technical and financial assistance to developing countries.

2. The policy foundations of European Community support for regional integration initiatives among developing countries

To some extent, the Community support for regional integration among developing countries is a consequence of its own success. While avoiding the explicit export of its own model of cooperation and integration, the Community sees regional initiatives as a way of overcoming the economic and political constraints of the traditional nation-State and views regional integration as providing an opportunity for developing countries to further their own political and socio-economic progress.

As the economic and political arguments for integration are well established in the literature, a few brief remarks will suffice to establish the European Community's case for regional initiatives among developing countries.

2.1. The economic arguments in support of regional integration

Different forms of economic integration schemes necessarily lead to different effects. Nevertheless, as the avowed goal of most integration schemes is to establish a customs union, this form of integration will be considered here, as the paradigm of developing countries' regional integration schemes.

From an economic point of view, the European Community sees regional integration as a sound opportunity for developing countries to reap gains from trade which would not otherwise be available. In effect, to the extent that, particularly until recently, most developing countries have had considerably high import barriers and have been reluctant to lower them, regional integration is a first step in the process of liberalization. In assessing the benefits of such moves and as regards the changes in trade patterns resulting from integration, it is important to ensure that the correct comparison is between no liberalization at all versus regional integration, and not necessarily between regional integration and *erga omnes* liberalization. From this perspective the integration gains from trade are of two kinds, the so-called static and dynamic gains from trade.

By eliminating trade barriers among themselves and replacing those on imports from third countries by a common external barrier, the members of a customs union effectively establish a preference for their products against those from third countries. Since this makes member countries' goods comparatively cheaper and third countries' goods comparatively dearer, this tends to increase imports from other member countries and decrease the relative level of imports from third countries.

To the extent that the change in trade barriers leads a member country to increase its imports of a certain good from a low-cost producing partner, there is trade creation, i.e. a gain in welfare for both trading partners resulting from the exploitation of comparative advantage. Further gains accrue also to non-members as a result of the members' increased real income (thus increased imports).

To the extent that the change in trade barriers leads a member country to replace imports of a certain good from a low-cost producing third country by higher-cost imports from a member country, there is trade diversion, i.e. a loss in welfare resulting from the inability to fully exploit comparative advantage. The difference between both sorts of welfare effects (i.e. trade creation minus trade diversion), accumulated for each member country, is referred to as the overall net static gains from integration.

Apart from these 'static' changes resulting from integration, there are also dynamic gains. While harder to quantify, they potentially are a more important source of welfare gains. These gains result from the changes that integration produces over time on the economic environment of member countries. In particular, dynamic gains are obtained from a better exploitation of scale economies (made possible by the larger size of the market, which also provides opportunities for a considerable saving of resources in research, education, health, etc.), improved market predictability and easier diffusion of technology. Furthermore, both the larger potential market and the more stable environment make regional integration a significant enticement for foreign direct investment.

To conclude, for developing countries regional integration can be a significant step forward towards freer trade and does not have to be a step backwards, as is sometimes argued, against multilateralism. Indeed, to the extent that overall protection declines and that *erga omnes* liberalization is contemplated, economic integration is a stepping stone towards integration in the world trading system and towards the strengthening of multilateral trade.

2.2. The political arguments in support of regional integration

Regional integration is more than eventually achieving a single market. Indeed, regional integration also involves more than economics and, as history has shown, the primary motivation for some regional integration schemes among developing countries, i.e. Asean, the Gulf Cooperation Council, etc., has been non-economic. Likewise, the motivations for the creation and the successive enlargements of the European Community were as much political as economic.

Thus, the gains from integration are not restricted to the static gains from trade creation and diversion, or to the scale economies and other dynamic effects from trade, or to perhaps obtaining better terms of trade. There are external relations gains for the countries involved, particularly in the form of geopolitical stability. While this can also be achieved through more specific, less interdependent means (such as security arrangements), regional integration schemes, by

their very nature, are capable of anchoring countries with each other in a firmer way. In this context, regional integration is considered by many as the best conceivable 'confidence-building measure' for peace in the Middle East.

On the internal side, regional integration has appeared in recent years as a means of strengthening democratic institutions. Thus, all over Latin America, the strengthening of regional integration schemes coincides with, and at least in part is responsible for, the political democratization and economic pragmatism which are the trade mark of today's Latin America. More to the point, in setting up new and renewed integration and cooperation schemes, it has been made clear that membership is restricted to countries with democratic governments and membership of integration groups has been interpreted as a guarantee against *coups d'état*.

Likewise, to the extent that a better allocation of resources and economies-of-scale gains will enhance income growth and employment prospects, regional integration can also contribute to reducing long-term social discontent as well as migratory pressures.

3. Integration efforts among developing countries

3.1. The spread and composition of well-established regional integration schemes

Regional integration initiatives have been numerous and widespread throughout the developing world since the 1960s. However, limitations of space make it impossible to describe in a comprehensive way all the existing schemes, even if the text were to be limited to those that have been under way for a long time and which are still providing mutual trade preferences for their members. Consequently, the major part of this subsection focuses on experience in Latin America whilst not neglecting developments in Asia and Africa. As regards certain Latin American groupings, more detailed data are given in the statistical annex to this chapter.

Regional integration experiences in Latin America and the Caribbean

As regards Latin America, the first integration scheme was the Latin American Free Trade Association or Asociación Latinoamericana de Libre Comercio (Lafta/ALALC). Established by the Montevideo Agreement of February 1960, it was formed by Mexico and the Spanish and Portuguese-speaking countries of South America. As Lafta never became the free trade area it was intended to be, the need to revamp the integration drive in the region, by adding flexibility to its arrangements and focusing on more realistic goals, led 10 years later, in August 1980, to its being reconstituted, by a new Montevideo Agreement, as the Latin American Integration Association or Asociación Latinoamericana de integración económica (LAIA/Aladi) which entered into force in March 1981. Less ambitious, in the short term, than Lafta, Aladi attempts to foster economic complementarity through the establishment of bilateral and subregional sectoral agreements, for which it acts as an umbrella organization. It contemplates, nevertheless, the eventual establishment of a single common Latin American market and given that goal it established in 1984 a mechanism for multilateral concessions under the name of PAR (Preferencia Arancelaria Regional). The challenges encountered in agreeing on and applying these preferences has shown how difficult it is to envisage an integration scheme (even a limited one) involving the whole region. As a result, Aladi's policy significance has been superseded by that of the subregional groupings in the continent, the emergence of some of which, namely Mercosur (to be discussed in the next section) has been nevertheless facilitated by the complementarity agreements (particularly, the Acuerdos de Alcance Parcial para la Complementariedad Económica) conceived by Aladi.

The earliest amongst the subregional groups in Latin America was the Central American Common Market or Mercado Común Centroamericano (CACM/MCCA), also referred to as the Sieca (Secretaria del Tratado de Integracion Económica Centroamericana), which was established just a few months after Lafta by the Treaty of Managua of October 1960. It entered into force in June 1961 and its members are Costa Rica (which joined in July 1962), El Salvador, Guatemala, Honduras and Nicaragua. The rapid reduction of intra-regional tariffs (whose elimination was contemplated by the Sieca agreement) led to a spectacular expansion of regional trade during the 1960s. The integration process (which reached the stage of a nearly fully implemented customs union) was interrupted and, in fact, reversed by the political and economic crises of the 1970s and 1980s (including ravaging civil wars, armed conflict between Honduras and El Salvador, the oil and debt crises and the collapse of their payments-clearing mechanism), so that the quantitative restrictions then introduced and the lack of implementation of the common external tariff considerably reduced the importance of intra-regional trade.

The end of the 1980s has witnessed a fundamental improvement in the political and economic conditions in the region. The ending of hostilities in Nicaragua and El Salvador and the momentum provided by both economic reform and the

re-establishment of a payments-clearing mechanism (which has since become unnecessary, as currencies have become convertible) have provided a better atmosphere for the resumption of both intra-regional trade (which has already begun to recover) and the furthering of integration.

Thus, a Central American Parliament was inaugurated in October 1991 and a broad institutional reform of integration mechanisms was undertaken in December 1991 with the creation of SICA (Sistema de la Integración Centroamericana) to watch over the three main integration pillars: the Central American Common Market as the instrument for economic integration, the Central American Parliament as the instrument for political cooperation, and the Odeca (Organización de Estados Centroamericanos) as the institutional instrument.

Although intra-regional trade has picked up in recent years, in nominal terms it is still half of what it used to be in 1980; thus, in spite of its recovery, as a proportion of total trade it is still somewhat above 10% while in the 1970s it exceeded 20% of total trade.

In contrast with extra-regional exports, more than two thirds of which tend to be agricultural, about three quarters of all intra-regional trade is in manufactures while agriculture accounts for most of the remainder.

The regional market is particularly important for manufactures: about 40% of El Salvador's, Guatemala's and Nicaragua's manufactured exports are regional, while Costa Rica and Honduras sell about 30% of their manufactures within the region.

Even though Costa Rica and Guatemala are the two largest total (i.e. intra plus extra-regional) exporters, most of the intra-regional trade is dominated by Guatemala, which accounts for nearly half of the intra-regional exports. Almost another half is accounted for, with roughly similar shares, by Costa Rica and El Salvador. Honduras and Nicaragua, the two weakest countries in the region, account together for about 10% of intra-regional exports.

The regional market has some significance only for El Salvador and Guatemala, for whom the region accounts for about 20% of all their exports. For the other three countries, the significance of the regional market has decreased considerably since the 1970s.

The Andean Pact or Grupo Andino, in turn, was established in May 1969 by the Acuerdo de Cartagena, and entered into force in October 1969. Its members are Bolivia, Colombia, Ecuador, Peru and Venezuela (which joined in February 1973). Chile, an initial signatory, withdrew in October 1976. More ambitious than Lafta, it was avowedly created as a way of circumventing the impasse into which the latter organization had fallen. Its programme included the need to find an intra-regional balance in the distribution of the benefits and costs of integration. The means that was envisaged to achieve this goal was the allocation to each member country of different production sectors so as to allow for country specialization through various industrial cooperation programmes. This attempt at regional programming was not very successful and this, together with the lack of implementation of the initial liberalization programme and the suspicious attitude towards foreign investment on the part of the region's governments, accounts for the very limited initial achievements of the Andean Pact. Various recent initiatives (notably the 1987 Quito Protocol and the 1991 Caracas Act) show a more outward-oriented and less interventionist approach to integration and may have created the momentum for further political and economic integration.

Yet, recent political events in the region (that have led to both internal instability and some frictions among member States), coupled with the resistance of the weakest countries (particularly, Peru and Ecuador) towards opening up to competition from the other member States, have prevented the attainment of the envisaged free trade area and the implementation of the common external tariff which had been foreseen for January 1992.

Trade within the Andean Pact has experienced a recovery in value terms during the second half of the 1980s, in contrast with total exports of the region which are at about the same level as they were in 1985. Yet, at around 4% of total trade, intra-regional trade is still considerably modest in relative terms.

The substantial increase in the relative significance of manufactures within intra-regional trade (from around 20% in 1970 to the current nearly 50%), mainly at the expense of agriculture and fuels, is probably one of the most important developments in the region's trade. This mirrors the evolution of extra-regional trade which, although historically dominated by fuel exports, is witnessing a progressive growth in manufactured exports. Nevertheless, the regional market still accounts for less than 15% of the member countries' total manufactured exports. The regional market is even more marginal for the remaining commodity categories.

Intra-regional trade tends to be dominated by Venezuela and Colombia (which are the major extra-regional exporters as well) which together account for about 60% of intra-

regional exports. Particularly significant in recent years has been the large increase in Ecuador's intra-regional exports which now account for about 20% of the intra-regional total.

Only for Ecuador, and to a lesser extent Bolivia, is the Andean market of some significance: it accounts for about 6 to 7% of these countries' exports. The opposite side of the coin is Venezuela which only sells about 2% of its exports within the region.

In the Caribbean, a Caribbean Free Trade Association (Carifta), was established in 1965 among the English-speaking Caribbean countries and territories with the objective of overcoming the smallness of these economies whose combined population is less than 6 million and which altogether have a GNP which is one third of Ireland's. While its progress was rather limited, it was replaced by the Caribbean Community/Caribbean Common Market (Caricom), established in 1973 by the Treaty of Chaguaramas. Its members are Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, and Trinidad and Tobago. The Bahamas is a member of the Caribbean Community but not of the Caribbean Common Market.

More perhaps than is the case of other regional groupings, the history of Caricom is one of over-ambitious goals and unfulfilled economic expectations. It is true that from a political point of view it has had its successes and has achieved increased cooperation in many technical and cultural fields. However, the same cannot be said in trade terms as intra-regional trade never reached 10% of total trade and since the early 1980s it has fallen every year.

In spite of a sense of a common cultural identity and of sharing a similar political history, the large number of countries involved and the enormous economic disparities between the two larger ones (Jamaica and Trinidad and Tobago) and most of the rest, has made it difficult to agree on a consistent and durable integration strategy.

Thus, in spite of frequent accords to eliminate intra-regional barriers to trade and enforce a common and single external tariff, the smaller islands have constantly pressed for and obtained waivers as regards the implementation of trade liberalization measures while the larger and more powerful economies have not hesitated to implement 'exceptional' measures on intra-regional trade when pressed by economic difficulties. One result has been uncertainty about trade prospects and consequently a reluctance by exporters to rely on regional markets. Another result has been an incomplete free trade area and insufficient progress in the creation of the foreseen customs union.

Nevertheless, at their summit meeting of July 1992 at Port of Spain, member States agreed to move forward towards a single market and established the year 2000 as their target date to achieve full monetary integration.

Regional integration experiences in Asia

As regards Asia, the Association of South-East Asian Nations (Asean) is the only regional grouping that has implemented (if somewhat timidly, until now) significant trade preferences among its members. Established in August 1967 by the Bangkok Declaration, it did not have a permanent Secretariat until February 1976 when it was established by the Bali Concord. Its five founding members are Indonesia, Malaysia, Philippines, Singapore and Thailand. Brunei became its sixth member in January 1984.

The creation of Asean in 1967 was based on a desire to attain a stable and secure political environment so as to enable its member countries to focus on economic development objectives. While members of Asean have individually become very successful as regards the growth of output and trade, Asean itself has not progressed much, until now, as a regional grouping. Indeed, although intra-regional trade is high by developing country standards, it has not changed significantly since its inception. The reasons are various. Notwithstanding the fact that there might be some lack of complementarity among Asean members, which, as a result, compete for many of the same international markets, other reasons also point to the lack of sufficient effective interest to further their integration and to Asean members' search for consensus in its decision-making.

Arrangements reached by Asean members, and particularly the so-called 'preferential trading arrangement' have not been very successful. First, not many of the commodities included in that arrangement were of significance for the member States. Second, cuts in tariff rates were not substantial. Third, non-tariff barriers were left untouched. Fourth, there has been a lack of institutions to implement and support integration efforts.

Nevertheless, reported current efforts seem to suggest a further strengthening of regional ties through the establishment of an Asean free trade area by the year 2007, the expansion of joint-venture industrial production and of 'growth triangles', and the institutionalization of regional security arrangements. All of these moves are expected to increase the importance of the Asean market for its member countries and to encourage foreign investment. The adoption, early in 1992, of the 'Six minus x' formula, allowing four or five member countries to integrate faster than the

group as a whole, could well have a significant impact on the pace of economic integration in the region.

Regional integration experiences in Africa

The earliest integration efforts in Africa were those which led to the creation of the Union douanière économique des Etats de l'Afrique de l'Ouest (Udeao) in June 1959. Reorganized in April 1973 by the Treaty of Bamako as the West African Economic Community or Communauté économique de l'Afrique de l'Ouest (CEAO), it entered into force in January 1974 and its members are Benin, Burkina Faso, Côte d'Ivoire, Mali, Mauritania, Niger and Senegal. The most successful of Africa's integration schemes, it has reduced tariff and non-tariff barriers and allowed for factor movements, which has led to labour flows from the Sahel to the coastal areas and facilitated specialization in production. Except for Mauritania, member countries have a common currency, a common central bank and limits on money creation and budget deficits. The grouping has dealt with the distributional effects of integration by creating a compensatory mechanism.

Unlike most other regional groupings, its intra-regional trade seems to have already overcome the difficulties of the late 1970s and early 1980s and, at more than 12% of total exports in the most recent years, it is at a historical high.

On the other hand, the other early and still-continuing effort in Africa, the Central African Customs and Economic Union or Union douanière et économique de l'Afrique centrale (Udeac), has been considerably less successful, even though its member countries also have the CFA franc as their common currency and from the beginning shared an investment code. Established in December 1964 by the Treaty of Brazzaville, it entered into force in January 1966 and its members are Cameroon, Central African Republic, Chad (which withdrew in 1968 but became a member again in December 1987), Congo, Equatorial Guinea and Gabon.

In spite of its auspicious start, the lack of sufficient political will and disagreements about the way to share the gains from integration made 'wet paper' out of most of the instruments of cooperation and integration: the common external tariff was made irrelevant by the establishment by member countries of varying import taxes, internal taxes were used to discourage intra-regional competition, the financing of regional infrastructures gave way to national projects, etc.

Nevertheless, recent policy changes suggest an attempt to both reduce the grouping's sheltering from international competition and to facilitate intra-regional competition.

3.2. Factors which account for the failure of developing countries' regional integration schemes in the recent past

As most observers recognize, and as some of the remarks in previous sections suggest, regional integration among developing countries has not, so far, been very successful. The most significant symptoms of the disappointing performance of regional integration schemes are the failure of intra-regional trade to grow as would have been expected, the failure of regional schemes to grasp a larger share of world markets and the institutional weaknesses of most integration initiatives. These three points are further explored below.

Symptoms of poor performance

The low growth rates, until recently, of intra-regional trade

Even though some groupings such as CEAO in Africa have experienced an important recovery in trade in the late 1980s, in general intra-regional trade has not grown significantly over the last 20 years, and currently accounts for only 5,4% of all developing countries' trade (compared to 4,6% in 1970). Secondly, as shown in Table 14, the share of intra-regional trade within the total trade of the integration groupings considered here has remained relatively static and is only about 11% of the total trade of these groupings (compared to almost 9% in 1970).

The unfulfilled promise of infant industry arguments

Two of the strongest arguments in support of early integration efforts and, particularly, their inward-looking orientation were the need to overcome the secular decline in the terms of trade and the infant-industry argument whereby, given the small size of national markets, developing countries needed regional markets in order to expand their industrial base. In addition such a regional market needed to be protected because otherwise infant industries would be unable to grow. However, it was argued that, over time, these industries would become competitive and would be capable of surviving without protection in world markets.

Although a direct test of this hypothesis is not possible with the available data, an indirect test, albeit insufficient, is provided in Table 15 below: the contribution to total developing countries' exports of countries belonging to integration schemes has shrunk from 60% in 1960 to around

Table 14

Intra-regional trade of a sample of developing countries' regional integration groupings as a percentage of total exports of each group

Group	1970	1976	1980	1983	1985	1989	1990
Aladi	10,2	12,8	13,5	10,2	9,6	10,5	10,4
Andean Pact	2,3	4,2	3,5	4,3	3,1	4,9	3,8
CACM (MCCA)	26,8	21,6	22,0	21,8	15,9	13,1	15,8
Udeac	3,4	3,9	4,1	2,0	2,0	5,9	4,3
CEAO	9,1	6,7	6,9	11,6	7,1	12,6	12,1
Asean	14,7	13,9	17,8	23,1	17,9	17,7	18,5
Total[1]	8,8	11,0	12,9	13,8	10,2	10,6	11,3

[1] Includes the Bangkok Agreement.
Source: Unctad.

40% today. While part of the decline is the result of the considerable fall in the terms of trade faced by many developing countries the evidence still supports the argument: the attempts made by developing countries to establish inward-looking regional integration were unable to reduce sufficiently the dependence on primary exports and to generate industrial exports.

The weakness of regional institutions

Institutional weakness is a problem prevalent throughout the developing world and regional integration organizations are no exception. Nevertheless, the relation between institutional weakness and economic and political performance is particularly complex. Thus, it can be argued that the weakness of integration institutions is one of the contributing factors to the lack of success of these groupings.

However, this lack of institutional strength is at the same time an indicator of the poor performance of these groupings: their inability or unwillingness to build the administrative and political capacity needed to carry out the tasks they set for themselves is evidence, in itself, of the lack of progress in integration.

Table 15

Exports of developing countries' regional integration groupings as a percentage of all developing countries' total exports

Group	1960	1970	1975	1980	1985	1988	1989	1990
Aladi	25,7	22,0	13,8	14,1	18,7	15,8	15,8	15,2
Andean Pact	12,4	9,3	6,0	5,5	5,5	3,2	3,9	4,2
CACM(MCCA)	1,6	1,9	1,1	0,9	0,8	0,6	0,7	0,6
Caricom	2,1	2,0	2,6	1,9	1,4	0,9	0,9	0,9
Udeac	0,8	0,8	0,8	0,8	0,9	0,6	0,5	0,6
CEAO	1,1	1,4	0,9	0,8	1,0	0,8	0,7	0,6
Asean	14,9	10,9	10,3	12,7	15,6	18,0	18,8	19,3
Total	58,5	48,3	36,5	36,6	43,8	40,0	41,3	40,8

Source: Unctad.

The financial fragility of regional institutions is additional proof of their weakness. This fragility is, to a large extent, caused by the lack of own resources so that administrative expenses have to be met by direct transfers from each member State, something that doesn't always happen in a timely manner. This, in turn, is a source of their lack of manpower and of their difficulties in carrying through challenging projects and tasks without outside assistance. The problem is compounded by the heavy burden that the proliferation of regional institutions has placed on national budgets. Indeed, the existence of large numbers of these schemes (in sub-Saharan Africa, for instance, there are more than 200 regional organizations) shows the extent to which integration initiatives often merely receive lip-service since adequate financing of them all is virtually impossible.

The underlying reasons for these unsatisfactory developments

Thus the failure of developing countries' regional integration groups to live up to the expectations generated in the 1960s and the 1970s is the result of the conjunction of a variety of circumstances, some internal to the schemes and some external to them.

Foremost among the internal factors has been the absence of an effective political commitment by national leaders to accept the political and economic costs resulting from integration.

A second element has been the philosophy and mechanics of integration as carried out by most regional integration schemes. As a rule, they embraced import-substitution strategies that, after some initial successes in achieving a degree of industrialization, led to increasing rates of inefficiency and biased the regional markets against exports. Furthermore, integration schemes often lacked the support of trade-facilitating physical and financial (i.e. payments-clearing mechanisms) infrastructures.

Thirdly, the similarity of relative factor endowments coupled with the small regional market size made it difficult for intra-regional trade to be a significant portion of total trade of each member State: export markets had to be found elsewhere.

Fourthly, the lack of burden-sharing mechanisms to compensate losers from policy changes made it difficult for national policy-makers to accept the risks of the short-term social and economic dislocations associated with integration.

Fifthly, the economic and financial crises led to placing a stronger emphasis on short-term national interests rather than on the long-term benefits from regional integration.

Sixthly, the technical complexity of integration 'engineering', particularly as countries advance towards further stages of integration, combined with inadequate administrative and human resources, is likely to have limited the chances of success.

As for the external factors, perhaps the most significant ones were the oil and debt crises and the concomitant reaction of many countries facing balance of payments constraints of erecting barriers to imports. This form of adjustment led to additional inefficiencies as well as to reductions in intra-regional trade.

Furthermore, when under pressure from international creditors and aid donors, developing countries began structural adjustments, the regional constraints resulting from countries' membership of integration groupings were not always taken into account. Thus countries were often encouraged, and indeed, implemented liberalization measures without due consideration to integration commitments, including the existence of regional preference margins.

3.3. The new approach to regional integration and cooperation

In contrast with the past, both the new as well as the renewed integration schemes now under way seem to be imbued with the new view of development that has become prevalent in recent years, namely the need for good governance, the critical role of structural adjustment, the significance of offering more room to private initiative and the progressive integration of developing countries in the world economy.

What makes the new efforts at regional integration especially significant is that they purport to be different from past ones.

First of all, as shown in Table 16, intra-regional trade has grown considerably in recent years in many of the groupings, thus suggesting that intra-regional liberalization has taken a higher priority than in the past.

Second, the lowering of intra-regional trade barriers has often coincided with the implementation of *erga omnes* trade liberalization measures.

Third, the new as well as the renewed schemes tend to be readily open to other possible partners.

Table 16

Most recent export performance of the major regional integration groupings of developing countries

Group	Value of intra-regional exports, 1990 (million USD)	Growth of exports, 1986-90	
		Intra-regional (%)	Extra-regional (%)
Aladi	11 670	10,5	16,0
Andean Pact	1 192	22,9	15,9
CACM (MCCA)	664	1,8	1,6
Caricom	273	−2,2	6,3
Udeac	180	28,6	9,0
CEAO	575	22,9	−2,7
Asean	26 290	34,2	27,4
Mercosur	4 059	14,2	13,3
UMA	372	33,5	13,1
GCC	3 774	12,1	16,8

Sources: Comtrade, Unctad.

Fourth, as part of active efforts towards economic liberalization, regional integration does not exclude the use of other external and broader liberalization exercises; that is, countries are often undertaking the lowering of trade barriers on several fronts. This is quite evident in the case of Latin America. Thus while Mexico has negotiated an FTA (free trade area) with the US and Canada, it has already concluded a similar agreement with Chile. Likewise, the Central American countries have agreed to have an FTA with Venezuela and another one with Mexico. And while Mercosur is still being created, there are already talks of reaching an FTA with the US.

Fifth, the programmatic definition of the new attempts is unambiguously outward-looking with clearly established deadlines for the establishment of common external tariff rates that are relatively low and have a low dispersion.

With these considerations in mind, it can be concluded that new integration efforts are forward-looking rather than defensive. Thus, references to a hostile international environment or the need to protect infant industries have been replaced by others to the effect of taking advantage of the challenges and opportunities posed by international markets, etc.

While it is still too early to gauge the results of the new efforts, available evidence attests to the dynamism of some of the new efforts. As shown in Table 16, the revival, in the most recent years, of intra-regional trade is considerable with solid growth of intra-regional exports in most groupings. Yet, this has not been at the expense of extra-regional trade. On the contrary, external trade, while growing at rates lower than intra-regional trade, has often expanded, in some cases rather spectacularly. Moreover, where external trade growth has been slow, intra-regional trade has been, in several cases, equally unsatisfactory.

3.4. Recent new regional integration initiatives

The revival of regional integration among developing countries has manifested itself not only in a reformulation of existing schemes but also in the establishment of new ones. While most of these are still in their infancy thus making it difficult to predict their chances of success, three of them are worth mentioning. One of them, Mercosur, is the regional grouping that currently seems to exhibit the strongest degree of commitment to succeed as a regional unit. The other two, UMA and the GCC, are both of great significance to the European Community, as their success might achieve a higher degree of stability in two areas where the geopolitical interests of the Community are considerable.

The Mercado Común del Cono Sur or Southern Cone Common Market (Mercosur) was established in March 1991 by the Tratado de Asunción. It is an extension, to a large extent, of a process of integration among Brazil and Argentina initiated in 1986 (as one of Aladi's partial complementarity agreements) and which in 1990 already contemplated the elimination of mutual tariff and para-tariff barriers by the end of 1994 and a binational common market. The Treaty entered into force in November 1991 and its members are Argentina, Brazil, Paraguay and Uruguay. A measure of its increasing appeal is the growing interest (and participation as observers at some of Mercosur's meetings) on the part of both Chile (which rejected initial invitations to be a founding member of Mercosur) and Bolivia (which, although a member of the Andean Pact trades more with Mercosur countries than with the Andean countries). It has shown great determination since its inception not to deviate from its deadlines and at its recent (June 1992) summit meeting at Las Lenas announced that intra-regional trade had grown by 25% between 1990 and 1992. Moreover, at this meeting Mercosur announced the adoption of a set of macroeconomic measures leading to economic convergence, the decision that a common external tariff will be approved by March 1993, and that the common market will be in place by December 1994.

However, recent political and economic uncertainties in Brazil as well as concern about a deteriorating trade balance in Argentina, coupled with worries about the structural

disparities among its member States, have raised doubts about the ability of Mercosur to meet its ambitious targets.

As available UN data (similar to those for other groupings) only run up to 1990, the increase in intra-regional trade resulting from the recent liberalization of trade barriers within the region can only partially be observed. Nevertheless, having declined significantly at the beginning of the decade (intra-regional trade in 1985 was half of its level in 1980), by 1989 a significant recovery of trade within the region was already evident. Nevertheless, at 8,3% of total trade, intra-regional trade is still below the 11,7% rate of 1980 and even that of 9,4% for 1970 (see statistical annex).

While at the beginning of the 1970s nearly two thirds of the trade among current Mercosur members was in agricultural goods and about one third was in manufactures, the ratios were already the opposite by 1980, and have remained so until the end of the 1980s. This evolution mirrors that of Mercosur countries' trade with the rest of the world: while agriculture accounted for 80% of their exports in 1970, this rate fell to about 60% in 1975, about 50% in 1985 and about 40% in 1989. As regards intra-regional trade, the figures for 1989 show, however, a change in the tendency, with a significant increase in the importance of agricultural trade, mostly the result of the growth of Argentinian exports to Brazil, an apparent result of the decline in trade barriers in these products. Fuels and mining altogether account for less than 10% of their trade.

Within its overall limited importance, the regional market is significant for most sectors, although there are major variations across countries. Thus, the regional market for both agricultural and manufactured goods is important for Paraguay as well as for Uruguay. In each of these sectors, intra-regional exports account for about 40% and 25% of all sectoral exports of Paraguay and Uruguay. The regional market for agricultural goods is also somewhat significant for Argentina, accounting for about 20% of this country's agricultural exports.

Even though total (i.e. intra plus extra-regional trade) exports from Brazil dominate the region's external trade (they account for nearly three quarters of all exports), the traditional dominant role of Brazil's trade within the region (accounting for about 50% of its trade) decreased markedly in 1989 to somewhat less than 40% as a result of the increased significance of Argentina's trade within the region (which has progressively increased since 1985 to a market share similar to Brazil's).

The importance of the intra-regional market varies with the countries: it is particularly significant for Paraguay and Uruguay for whom it accounts for about one third of total exports. It has some importance for Argentina, recently accounting for almost 15% of exports, and a marginal importance for Brazil for whom it represents less than 5% of exports (versus 9% in 1980).

The Union du Maghreb Arabe or Union of Arab Maghreb (UMA) was established in 1989 and consists of Algeria, Libya, Mauritania, Morocco, and Tunisia. Its creation was thought to reflect a new climate of peace in the region and was seen as an opportunity to develop trade links based on the perceived complementarities of the region (energy sources in Algeria and Libya, important agricultural and agro-industrial sectors in Morocco, heavy industry in Algeria, mining resources in Morocco and Mauritania). Nevertheless, in spite of the enthusiasm of early political declarations, the process of integration has not taken off.

Trade within the region has traditionally been marginal and, at less than 2% of total trade, remains so. This is in spite of a spectacular increase in intra-regional trade since the mid-1980s propitiated in part by the decrease in intra-regional frictions as well as by the significant liberalization in the import regimes of both Morocco (since 1983) and Tunisia (since 1986).

Still, some member States simply do not trade at all with certain other partners in the group, thus Libya does not import from any UMA country while Mauritania does not export to any of them. And this bleak picture is, nevertheless, a significant change from the situation in the mid-1980s when only Tunisia traded with two Maghreb countries, while all the other member States only had one Maghreb trading partner.

Although there is some evidence of significant informal trade among neighbouring countries (particularly among Algeria and Morocco), the disparities in economic policy approach (the market orientation of Tunisia and Morocco contrast markedly with the statist orientation of the other two main partners, Algeria and Libya), coupled with the traditional orientation of their export strategies toward European markets, place a significant question mark on the extent to which integration will progress in the medium term.

Furthermore, the current internal difficulties in some of its member countries and the still-unresolved political disagreements on some bilateral issues help explain why the effective furthering of integration does not seem to have been on the top of the agenda of these countries and suggest the need for a waiting period as regards the ability to gauge how far UMA will go in the immediate future.

Less recent than the UMA or Mercosur (it was established in 1981), the Gulf Cooperation Council (GCC) differs from the groupings referred to in the earlier section in that it was created after the oil crisis of 1979-80 and precisely at the time when many integration groupings began to falter.

Formed by Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates, its original goal was, to a large extent, based on geopolitical considerations (namely, to face security threats in the region from Iraq, Iran and Yemen). Still, the countries in the region shared more than common threats; in particular they had similar views on global strategic issues. They also shared similar political systems, cultures and political history and in many respects the GCC agreement multilateralized the bilateral pacts and agreements that already existed as regards scientific, educational, cultural and economic cooperation.

Although as a rule import duties among GCC member States were eliminated as of March 1983, there are significant exceptions to this rule, particularly as regards some industrial products. As regards agricultural and animal products most are not subject to these duties.

These exemptions mentioned above, as well as various other non-tariff barriers (including national preferences as regards public procurement, regional content and regional ownership requirements), the absence of a common external tariff (there is, however a maximum tariff of 20% and a minimum tariff of 4%), and the strong (even if declining) specialization in oil exports go a long way in explaining the marginal role that intra-regional trade plays in the region: less than 5% of all exports is accounted for by those among GCC member States (versus 3% in 1980, the year before the establishment of the GCC).

Indeed, intra-regional trade is currently somewhat less significant, as a proportion of total trade, than it was in the mid-1980s. Furthermore, this aggregate figure overshadows substantial disparities among member States. Thus, Bahrain is the only country which can be said to depend on the regional market (its exports to the region account for nearly one quarter of all of its exports). On the other hand, the regional market is practically irrelevant for Oman and Kuwait (with intra-regional trade shares in total trade of less than 1 and 2% respectively).

Numerous deadlines have been missed until now in the efforts to establish a common external tariff. However, as part of a reinforced drive towards further integration, member States have agreed that the new tariff will be in force by March 1993.

Finally, while from the trade point of view there is ample room for improvement, other economic and political gains have been significant. As for the first, there has been an increased coordination in monetary policy and there is considerable freedom of movement of people. As for the latter, GCC member countries now enjoy a larger international political weight and frictions among them have been reduced.

4. How to make regional integration a successful instrument of development

The interest among developing countries in regional integration continues despite the failures of the past. This raises the important policy question as to what the factors are which increase or (on the contrary) reduce the chances of success of these schemes.

As previous discussions have indicated, regional integration is not exclusively or even primarily an economic phenomenon but also a political one. Thus, two groups of factors affecting these chances of success (political and economic) can be identified.

As regards the political conditions for successful regional integration, the will to carry out effectively the integration project is perhaps the critical factor in ensuring the success of regional integration schemes. In turn, for this will to go beyond political rhetoric, the countries concerned must be committed to accepting the short-term adjustment costs associated with integration, hopefully mitigated through the use of mechanisms (such as those discussed below) for the improvement of social and regional cohesion. They must be committed, as well, to the building of strong common institutions, establishing sensible and clear goals for them and providing for their rational management and their accountability.

As regards the economic conditions for successful regional integration, and noting that an increase in welfare via the growth of trade and foreign direct investment is, by definition, the major economic objective of regional integration, the factors that promote increases in trade and foreign investment are key determinants for the success of these schemes.

In this respect, the most important conditions for success relate to three different areas. First, to the type of policies designed for the implementation of integration and economic reform. Second, to the existence of a trade-conducive atmosphere. Third, to the presence of certain institutional arrangements that can help finance trade expansion and the structural adjustments engendered by it.

As for the first area, i.e. policy design conditions, the two most significant ones refer to the need for an integration model open to world trade and to paying due regard to the regional aspects of structural adjustment. In other words, the maintenance of some degree of regional preference has to be coupled with an openness of the integration schemes to new entrants and, more generally, to competition from abroad.

This openness is the best insurance against the trade-diverting effects overcoming those from trade creation. It also guarantees that intra-regional industries remain dynamic and make good use of their comparative advantage. The most direct test of this orientation is by observing the evolution of import barriers *vis-à-vis* the rest of the world: the lower the barriers against third countries and the faster they decline, the larger trade expansion and the economic health of the regional industries will be.

On the other hand, the design of structural adjustment measures must take account of the regional dimension of the changes conceived in the reforming member States. Indeed, the objective of structural adjustment programmes is to reduce resource misallocations, increase the incentives for productive investment and create the conditions for durable growth thus furthering the integration of the developing countries concerned into the world economy. On these grounds, effective structural adjustment should assist regional integration.

Yet, as structural adjustment programmes are typically designed and implemented at the national level, structural adjustment programmes undertaken by different countries belonging to the same integration grouping often exhibit substantive differences as well as different timetables and sequences of implementation. As a result, they may not be mutually consistent and coherent thus provoking intra-regional distortions, imposing adjustment costs on partners in the integration grouping and adversely affecting the functioning of regional agreements.

To avoid these problems and thus facilitate the success of regional integration schemes, structural adjustment programmes of countries belonging to a regional grouping need to be coordinated and harmonized, so that regional interdependence and economic policy commitments to integration partners are taken into account.

As for the second area, trade-conducive conditions, three are specially relevant. The first refers to the very foundations of trade: intra-regional trade is more likely to expand the larger the opportunities are for the exploitation of comparative advantage and of economies of scale. Other things being equal, this calls for a large, rather than a small, number of partners and for partners with diverse relative factor endowments.

The second concerns the existence of trade-facilitating infrastructures (namely, transportation and communication networks), which, *ceteris paribus*, tend to be made more feasible with geographic proximity and less so in the presence of physical barriers such as seas or mountain chains. The existence of these infrastructures prior to integration is a significant factor in the success of regional integration: thus, the difficulties of crossing the Andes are often mentioned as one of the main difficulties for Andean integration. But, evidently, policy decisions can do much, as well, to relieve bottlenecks in this area.

The third is a supporting international trade environment provided by the industrialized countries as well as by international institutions, which can play a significant role in the success or failure of these schemes. Support from the former can be provided by streamlining rules of origin for goods the production of which takes place in more than one developing country. Support from the international institutions can be provided by not requiring developing countries that belong to integration units to undertake trade policy measures that go against their regional integration commitments.

As for the third area, institutional arrangements necessary for success, two of them in particular can help reduce the short-term dislocations associated with the implementation of integration measures and thus the opposition from the parties in difficulties: intra-regional compensation mechanisms and payments-clearing facilities.

Intra-regional mechanisms to compensate short-term losers and to reduce the unevenness in the distribution of the benefits from integration can be a powerful instrument to furthering integration. Indeed, the implementation of regional integration measures, as any other policy change, is likely to produce not only gainers but, in the short term, losers as well. These losers will be the owners of production factors which, as a result of the price changes associated with the changes in import barriers, are no longer competitive at the regional level.

The resistance and political opposition of these losers can be more easily overcome if there are mechanisms ('social funds') that compensate these losers, at least partially, via the provision of education or retraining, longer unemployment benefits, investment incentives, etc. To the extent that losses often affect industries located in particular areas similar mechanisms ('regional funds') can be used to finance local infrastructures or to provide tax advantages in the affected

subregions. As some countries within the overall grouping are likely to benefit more than others from the implementation of regional measures, other mechanisms can provide for inter-country transfers ('cohesion funds') to assist the poorer members of the regional grouping.

On the other hand, to the extent that many developing countries' currencies are non-convertible, exporting to industrialized countries (thus, outside the integration grouping) is often more attractive than exporting to a member of the regional group because the former brings forth currency that can be used universally while the latter simply allows for a disguised form of barter trade.

An effective way of getting around this problem and thus facilitating intra-regional trade, while economizing hard-currency foreign exchange, is to establish payments-clearing facilities through which member countries can exchange the payments credits with other members of the regional grouping. As the mechanism is designed, by definition, to accommodate short-term imbalances, its success depends on two factors. First, on a sufficiently large reserve of funds to finance these imbalances. Second, on the absence of permanent, structural payments imbalances, such as those caused by high barriers to intra-regional trade and by a long-term currency overvaluation or, even, undervaluation, in a given member country. When this is the case the accumulation of large credits by some countries and corresponding debits by others will, inevitably, use up the funds that support the mechanism, thus resulting in its bankruptcy.

Evidently, these 'conditions' do not apply equally to all integration groupings. Likewise, none of them, even together, might be sufficient for the success of integration efforts. However, the experience of past failures suggests that ongoing integration efforts need to be aware of the difficulties of succeeding when these conditions are not present.

Statistical annex

Southern Common Market (Mercosur) — Share of intra-regional trade in total trade, by country

(%)

	1970	1975	1980	1985	1986	1987	1988	1989
Argentina	10,2	9,8	14,2	8,0	12,7	12,1	9,6	14,9
Brazil	8,2	6,8	9,1	3,9	5,5	5,0	4,7	4,4
Paraguay	33,5	33,1	40,2	27,0	57,4	36,0	30,4	38,4
Uruguay	9,5	25,2	32,7	24,7	34,8	27,2	24,2	32,9
Total	9,4	8,5	11,7	5,6	8,5	7,4	6,6	8,3

Southern Common Market (Mercosur) — Share of intra-regional trade in total trade, by product group

(%)

	1970	1975	1980	1985	1986	1987	1988	1989
Agriculture	6,8	5,2	7,0	3,9	7,4	5,3	4,4	8,1
Fuels	20,4	32,9	32,4	7,2	16,3	10,2	11,7	11,3
Minerals/mining	6,9	6,3	4,5	3,8	6,6	5,4	3,7	4,7
Manufactures	25,0	15,8	19,8	7,8	9,7	9,7	8,8	9,0
Total	9,4	8,5	11,7	5,6	8,5	7,4	6,6	8,3

Southern Common Market (Mercosur) — Relative importance of each product group in intra-regional trade

(%)

	1970	1975	1980	1985	1986	1987	1988	1989
Agriculture	57,6	39,0	34,5	33,4	39,7	30,1	27,5	38,0
Fuels	1,1	7,1	6,0	8,3	5,4	4,2	4,2	3,5
Minerals/mining	4,5	6,7	2,7	5,0	6,5	6,1	5,0	5,3
Manufactures	36,8	47,2	56,7	53,3	48,4	59,6	63,3	53,2
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0

Sources: Comtrade and Commission estimates.

Central American Common Market (MCCA) — Share of intra-regional trade in total trade, by country

(%)

	1970	1975	1980	1985	1986	1987	1988	1989
Costa Rica	19,7	21,6	26,8	14,8	8,9	9,7	n.a.	n.a.
El Salvador	32,3	27,6	41,1	25,7	12,4	19,5	n.a.	n.a.
Guatemala	35,3	26,9	27,2	20,5	17,9	25,8	n.a.	n.a.
Honduras	10,6	9,1	10,3	2,8	2,4	3,4	n.a.	n.a.
Nicaragua	26,4	24,9	18,2	9,0	6,5	11,7	n.a.	n.a.
Total	26,1	23,3	25,4	15,5	10,6	14,2	n.a.	n.a.

Central American Common Market (MCCA) — Share of intra-regional trade in total trade, by product group

(%)

	1970	1975	1980	1985	1986	1987	1988	1989
Agriculture	8,0	5,8	6,3	3,3	2,8	4,4	n.a.	n.a.
Fuels	16,3	39,4	50,4	29,8	8,6	6,1	n.a.	n.a.
Minerals/mining	21,1	13,3	12,4	29,7	30,8	32,0	n.a.	n.a.
Manufactures	92,1	82,8	82,3	67,8	55,2	55,7	n.a.	n.a.
Total	26,1	23,3	25,4	15,5	10,6	14,2	n.a.	n.a.

Central American Common Market (MCCA) — Relative importance of each product group in intra-regional trade

(%)

	1970	1975	1980	1985	1986	1987	1988	1989
Agriculture	23,4	18,7	17,6	16,9	21,8	24,5	n.a.	n.a.
Fuels	0,5	1,5	2,5	3,0	1,0	0,4	n.a.	n.a.
Minerals/mining	1,4	1,2	1,7	3,0	2,5	2,5	n.a.	n.a.
Manufactures	74,7	78,5	78,2	77,0	74,8	72,5	n.a.	n.a.
Total	100,0	100,0	100,0	100,0	100,0	100,0	n.a.	n.a.

Sources: Comtrade and Commission estimates.

Andean Pact (Pacto Andino) — Share of intra-regional trade in total trade, by country

(%)

	1970	1975	1980	1985	1986	1987	1988	1989
Bolivia	2,2	3,8	4,1	2,5	3,8	5,4	4,6	6,3
Colombia	7,1	11,3	9,7	6,1	5,5	5,2	7,0	5,4
Ecuador	4,7	13,5	5,9	2,5	2,0	6,2	10,5	7,8
Peru	1,8	3,2	8,5	7,0	6,2	6,4	6,3	5,6
Venezuela	0,8	1,3	1,8	1,1	1,9	3,1	2,3	2,4
Total	2,1	3,6	3,9	2,6	3,4	4,3	5,0	4,1

Andean Pact (Pacto Andino) — Share of intra-regional trade in total trade, by product group

(%)

	1970	1975	1980	1985	1986	1987	1988	1989
Agriculture	3,0	4,9	4,7	3,1	2,2	3,3	3,0	3,6
Fuels	1,1	2,2	1,4	0,8	0,5	2,0	1,7	1,4
Minerals/mining	1,6	2,1	2,9	3,2	6,6	7,4	6,5	4,3
Manufactures	18,3	24,6	24,5	11,4	18,6	14,9	19,5	13,2
Total	2,1	3,6	3,9	2,6	3,4	4,3	5,0	4,1

Andean Pact (Pacto Andino) — Relative importance of each product group in intra-regional trade

(%)

	1970	1975	1980	1985	1986	1987	1988	1989
Agriculture	36,0	23,5	21,6	21,5	21,4	16,3	14,5	18,5
Fuels	30,3	44,9	28,5	19,3	7,7	28,9	18,9	20,2
Minerals/mining	12,7	5,4	7,8	13,6	15,4	14,7	15,7	11,2
Manufactures	20,9	26,1	42,1	45,6	55,5	40,0	50,9	50,1
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0

Sources: Comtrade and Commission estimates.

III — The developing countries in the 1980s

A — The preferential regimes covering EC imports

1. Introduction

This chapter looks into some aspects of the Community's preferential trading relations, particularly those with the developing countries. Trade preferences have always played an important role in shaping the trading relations of the Member States, in particular with their former colonies. The successive Lomé Conventions, succeeding the Yaoundé Conventions of Association, extended and deepened such preferences, so that at present (Lomé IV) 69 developing countries of the African, Caribbean and Pacific regions benefit from preferential, and in most cases unrestricted, access for almost all products to the largest market in the world. For the non-ACP developing countries the Mediterranean preferences and the preferences accorded under the generalized system of preferences (GSP) constitute the major instruments through which the Community extends preferential access to its market.

2. A brief overview of the Community's preferential trading relations

The Community has extended through a number of instruments preferential, non-reciprocal, trade benefits to the various groups of developing countries (ACP countries and the overseas territories of the Member States, the Mediterranean countries and the Asian and Latin American countries). In addition preferential, but reciprocal, trade agreements (free trade areas, customs unions and intermediate types of arrangements) have been concluded with the EFTA countries (to be replaced in due course with the EEA), the East and Central European countries (Hungary, Poland and the Czech and Slovak Federal Republic), Turkey, Israel, Malta, Cyprus and San Marino. In the latter case, such type of agreements have often been precursors to membership of the Community for a number of countries; the United Kingdom, Spain and Greece are particular examples. The EFTA countries which have applied for membership of the Community (Austria, Sweden, Finland and Switzerland) are obvious examples of such cases in the near future, while also in the case of the East and Central European countries, the preferential trading relations are now considered as an intermediate stage towards a free trade area, followed by full membership of the Community in the more distant future.

Free trade area negotiations should shortly be under way with the countries of the Gulf Cooperation Council (Bahrain, Kuwait, Qatar, Oman, Saudi Arabia and the United Arab Emirates), while for Romania and Bulgaria negotiations have started for the conclusion of so-called 'Europe Agreements', similar to the ones concluded with Poland, Hungary and Czechoslovakia. Trade and cooperation agreements have also been concluded with the Baltic States and Albania. These countries, together with Romania and Bulgaria, enjoy at present preferential treatment under the GSP.

Lastly, at the Lisbon Summit of June 1992, the European Council indicated that 'ultimately, by stages' a free trade area between the Community and the Maghreb countries could be set up; in this context the Commission has already had some preliminary discussions with Morocco.

These developments underscore the continued importance of preferential trading relations in the Community's external trading relations, which stem on the one hand from historical circumstances (in particular the relations of individual Member States with individual ACP countries), and on the other hand from political exigencies. This policy has been criticized by trade policy analysts on the grounds that it has weakened the Community's commitment towards the multilateral GATT system. While this remains ultimately a matter of judgment, it is important to underline the Community's commitment to uphold Article XXIV of the GATT, which defines under which conditions preferential trading relations, such as free trade areas and customs unions, are GATT compatible. Also the Community's contribution to the work on Article XXIV in the context of the Uruguay Round should be noted in this respect.

3. The Community's preferential trading relations, in particular with the developing countries

Traditionally, preferential trading relations have concentrated on preferential tariff treatment. As tariffs constituted the main, and often only, instrument of protection, preferential tariff treatment constituted an effective device for extending an economic advantage to a preferred source of imports.

However, as the importance of tariffs has been reduced, so the degree of preference is increasingly determined not by the tariff preference as such, but by other factors which determine to what extent a country can in actual fact benefit from trade preferences. Among the factors determining the extent to which a country can benefit from preferential trading relations the following are of particular importance.

This concerns in the first place the so-called 'rules of origin'. Rules of origin determine what conditions are required to be fulfilled if an imported consignment from a certain preferred

country is to benefit from preferential treatment, that is to meet the requirement of 'sufficient processing' in a particular country or group of countries. In the case of unprocessed agricultural and mineral products, the determination of the origin of a product does not pose in general a problem, but in the case of manufactured products, with the likelihood that different stages of processing are carried out in different countries, the situation is quite different. For these products, the preferential agreements concluded by the Community define a change of tariff heading in general as a sufficient condition to meet the rules of origin requirements, although in certain exceptional cases additional conditions are imposed, such as, for example, a *de minimis* requirement of the share of the value of non-originating materials. While such rules are necessary, in order to ensure that the benefits of the preferential treatment accrue to the preferred country, the definition of these rules always requires a careful balancing of, on the one hand, the requirements stemming from preferential treatment (the preference should be utilized by the beneficiary country) and, on the other hand, the fact that the international economy is subject to a process of increasing specialization; too strict rules of origin requirements could have substantial distorting allocative effects on this process, particularly in cases where the preferential margins are considerable. Rules of origin of preferential trade regimes also contain provisions with respect to regional cumulation, as well as the treatment of the so-called donor content. Regional cumulation provisions allow preferential countries belonging to a recognized regional grouping to count inputs originating in any of the countries belonging to that regional group as originating inputs;[1] this fosters the process of regional specialization and cooperation. Examples of this are provisions in the Lomé Convention, as well some of the Mediterranean agreements (Maghreb), the GSP (Asean and Andean Pact), the Europe Agreements, the EFTA and the EEA agreement. Similarly, donor content provisions allow inputs originating in the country which extends the preferences to be counted as originating input; most Community preferential agreements, with the exception of the GSP, have provisions to this effect.

The treatment of non-tariff barriers (quantitative restrictions, but also non-tariff barriers in the context, for example, of the common agricultural policy), are also important determinants of the degree of preference extended. Equally, tolerance and derogation provisions, like for example those contained in the Lomé Convention, provide a degree of flexibility which can be of particular importance to the countries for which the trade preferences are meant. Also the question of product exclusions or limitations of trade preferences is important, as well as the matters of safeguards and dispute settlement.

[1] In this regard a further distinction can be made between the so-called cumulation of process system ('full cumulation') and the cumulation of origin system.

In summary, the actual degree of preference extended under a preferential scheme does not only depend on the depth and the scope of the tariff preference; other factors, as briefly enumerated above, are of equal, if not greater, importance. As regards the Community's preferential schemes with developing countries, the main features are described in Table 17 for each of the group of countries distinguished, i.e. the Lomé countries, the Mediterranean countries, the GSP countries and the least developed countries regime extended under the GSP. While among each of these four groups of preferential regimes the beneficiary countries share important characteristics in their preferential treatment by the Community, this should certainly not be interpreted as meaning that countries belonging to the same preferential group receive identical preferential treatment. This is particularly the case for the GSP regime, which reveals in practice, as a result of the differences in product composition of the beneficiaries and, in particular, the graduation/differentiation policy,[2] important differences in the actual utilization of trade preferences, as will be discussed below.

4. The importance of preferential trading regimes

The best way to obtain an overview of the importance of the preferential trading relations of the Community is by presenting the trade flows covered by the various preferential arrangements.[3] This is done in Table 18.

Table 18 shows clearly the relative importance of the various types of preferential agreements. About 33% of the total 1991 Community imports originated in countries with whom the Community has entered, or will do so in the foreseeable future, into reciprocal preferential trading arrangements (EFTA, Israel, the East and Central European countries, Turkey, Malta and Cyprus, GCC countries), about 8% in countries to whom the Community has extended contractual

[2] Graduation for industrial products (excluding textiles and clothing) is applied through the progressive withdrawal of preferences, for sensitive products only, carried out in two stages. In Stage One the preferential tariff quota is reduced by 50%, with in Stage Two preferential treatment being completely terminated. Stage One of the reduction in preferential treatment is triggered by a minimum share in extra-EC imports of the product concerned (20%) or by a volume of imports of the product concerned exceeding 10 times the preferential tariff quota. Preferential treatment is withdrawn in the year following the reduction, provided one of the conditions for the preference reduction continues to be met. For textiles and clothing (MFA products) preferences differentiation is applied in a slightly different manner.

[3] Note that preferential trading relations with such countries as Andorra, San Marino and the Occupied Territories are not included, simply because the volume of trade falling under these arrangements is too small.

Table 17

The Community's main preferential trading relations with the developing countries

Beneficiary	Safeguards, exceptions, rules of origin	Agriculture	Industrial products, excluding textiles	Textiles and clothing	ECSC products
ACP countries	Safeguard measures authorized; these have, however, not been invoked. Rules of origin, which are in general the least restrictive compared to other preferential trade regimes provide for ACP/EC cumulation; provisions for derogation procedures in case rules of origin requirements are not met; provision for general tolerance on the use of non-originating materials.	Non-CAP products enter without restrictions. Preferential treatment for rum, bananas, sugar and beef. Abolition of customs duties on all agricultural products; for selected products reduction of CAP charges (fixed component, variable levies, etc.) within certain quantitative and seasonal limits.	Duty-free entry for all industrial products, with no quantitative limitations.	No limitations on duty free preferential treatment.	Duty-free access for all ECSC products, with safeguard clause.
Mediterranean countries	Rules of origin provide for EC/beneficiary cumulation, as well as, for example, Maghreb cumulation for the Maghreb countries.	Non-CAP products enter without restrictions. At present still reduction of duties on products covered by CAP; full elimination of customs duties within certain quantitative and seasonal limits starting in 1993.	Duty-free entry for all industrial exports, with no quantitative limitations.	In general no limitations on duty-free preferential treatment; in a few cases administrative cooperation in order to avoid disruption of the Community market.	Duty-free access for all ECSC products, with safeguard clause.
GSP countries	Limitations on preferences for sensitive products; for non-sensitive products safeguard measures might be invoked if imports from a single country exceed a certain reference margin. Rules of origin more restrictive than in the case of ACP and Mediterranean preferential trade regimes; however regional cumulation (Asean, Andean pact) is provided for.	Reduction or abolition of duty on certain agricultural products; for five product categories, limitations by tariff quotas (pineapples, coffee extracts, unmanufactured tobacco). For a number of products 50% reduction in agricultural levies (meat products and potato starch).	Duty-free entry for industrial products with some primary products being excluded; no limitations for non-sensitive products. Limitations (product/country-specific) for sensitive products, either through the imposition of country-specific fixed duty-free amounts or through so-called tariff ceilings. Graduation, i.e. exclusion of preference benefits, based on	Within tariff quotas/tariff ceilings duty-free access for GSP-eligible countries with whom the Community has concluded MFA agreements. Duty-free entry of jute and coir products for India, jute only for Thailand and coir only for Sri Lanka.	For one group of products duty-free access with country-specific tariffs, quotas or tariff ceilings, while for another group duty-free access for each of the countries individually within the limits of a Community ceiling corresponding to 102% of the highest maximum amount for 1980 under each of the preferential ceilings opened for that year.

Beneficiary	Safeguards, exceptions, rules of origin	Agriculture	Industrial products, excluding textiles	Textiles and clothing	ECSC products
			objective criteria, that is related to performance of a country in the Community market.		
GSP countries, least developed countries regime	Safeguard measures for ordinary GSP countries do not apply for these countries. Rules of origin at present still the same as for ordinary GSP beneficiaries. Reform considered (tolerance margin, derogation possibility, etc.).	Abolition of duty on selected agricultural products. No tariff quotas, except in case of coffee extracts. For a number of products 50% reduction in agricultural levies (meat products and potato starch).	Duty-free entry of all industrial products with no quantitative limitations. Same products excluded as for ordinary GSP beneficiaries. No reimposition of duties once ceilings/fixed duty-free amounts have been exhausted.	Duty-free entry of textile and clothing products, as well as duty-free entry of jute and coir products.	Same as for ordinary GSP beneficiaries, but no reimposition of duties.

Table 18

The main preferential trading relations of the Community in 1986 and 1991

(in billion ECU or, in between brackets, as a % of total extra-EC flows)

	Imports		Exports	
	1986	1991	1986	1991
Total extra-EC	336,8 (100,0)	493,8 (100,0)	344,6 (100,0)	423,5 (100,0)
Part of the Community's customs union				
Overseas departments	0,4	1,8	2,4	9,3
Free trade area (reciprocal)				
All countries listed below	81,2 (24,1)	114,1 (23,1)	91,5 (26,6)	114,8 (27,1)
EFTA	78,7	110,7	87,2	108,9
Israel	2,5	3,4	4,3	5,9
(Reciprocal) arrangements with East and Central European countries				
All countries listed below	15,0 (4,5)	23,7 (4,8)	19,4 (5,6)	24,3 (5,7)
Former Yugoslavia	4,9	7,5	5,8	6,8
Poland	3,0	6,2	6,8	7,9
Czechoslovakia	2,1	4,1	1,9	3,8
Hungary	1,9	3,6	2,4	3,5
Bulgaria	0,6	0,8	1,5	1,0
Romania	2,5	1,5	1,0	1,3
Reciprocal concessions, moving to enhanced forms of integration				
All countries listed below	3,8 (1,1)	7,5 (1,5)	6,3 (1,8)	11,1 (2,6)
Turkey	3,1	6,2	4,7	8,2
Malta	0,4	0,7	0,7	1,4
Cyprus	0,3	0,6	0,9	1,5

	Imports		Exports	
	1986	1991	1986	1991
Non-reciprocal contractual concessions				
All countries listed below	31,5	36,6	33,9	35,4
	(9,4)	(7,4)	(9,8)	(8,4)
Lomé Convention	19,7	19,1	16,2	15,9
Overseas territories	0,2	0,7	0,7	1,4
Mediterranean countries				
Maghreb [1]	9,1	13,1	9,5	11,2
Mashreq [1]	2,5	3,7	7,5	6,9
Non-reciprocal GSP concessions, moving to free trade area				
GCC countries [1]	2,5	13,5	14,8	16,8
	(3,7)	(2,7)	(4,3)	(4,0)
Other countries receiving unilateral GSP concessions				
All countries listed below	52,2	83,9	42,6	63,0
	(15,5)	(17,0)	(12,4)	(14,9)
Middle East				
Iran	3,0	6,3	3,7	7,5
Irak	3,4	—	2,8	—
Asia				
Asean [1]	9,2	19,9	8,5	17,3
Hong Kong	5,3	6,4	4,2	7,4
China	4,3	15,0	6,5	5,6
South Asia [1]	4,0	7,7	3,0	7,1
Other Asia [1]	0,7	1,0	0,4	0,5
Latin America				
Andean 4 [1]	3,1	3,2	2,0	1,9
CACM [1]	1,1	1,0	0,6	0,7
Mercosur [1]	10,3	13,8	5,6	6,1
Venezuela	1,5	1,6	1,9	1,9
Mexico	2,4	3,0	2,0	4,8
Chile	1,5	2,5	0,7	1,1
Other countries, MFN or predominant MFN treatment				
All countries listed below	131,3	203,8	121,8	141,5
	(39,0)	(41,3)	(35,3)	(33,4)
USA	56,9	91,8	75,2	71,2
Canada	6,5	9,9	9,1	9,3
Japan	33,5	51,8	11,5	22,2
South Korea [2]	4,3	7,8	3,1	7,1
Australia	4,1	4,5	5,8	6,2
Taiwan	4,7	11,1	2,5	5,5
Former USSR	13,2	18,5	9,9	14,2
South Africa	8,1	8,4	4,7	5,8

[1] Maghreb: Algeria, Morocco, Tunisia
Mashreq: Egypt, Jordan, Lebanon, Syria
GCC countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates
Asean: Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand
South Asia: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan
Other Asia: Afghanistan, Cambodia, Laos, Macao, Myanmar, Mongolia, North Korea, Viet Nam
CACM: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua
Andean 4: Bolivia, Colombia, Ecuador, Peru
Mercosur: Argentina, Brazil, Uruguay, Paraguay

[2] South Korea is at present again a GSP beneficiary; however, from 1988 to 1991 GSP benefits for South Korea have been suspended because of discriminatory treatment of Community companies by South Korea in the area of intellectual property rights; for that reason South Korea is shown, in 1991, as a beneficiary of MFN, rather than GSP, treatment.

Source: Eurostat.

non-reciprocal trading concessions (Lomé countries and the Mediterranean countries), 18% in countries to whom the Community has extended unilateral GSP concessions (the non-ACP developing countries), while the remaining imports (about 42%) originated in countries to whom the Community extends MFN treatment or predominantly MFN treatment (the industrial countries).

Although the share of countries receiving exclusively or predominantly MFN treatment is only 42%, in actual fact, the overall importance of the MFN regime is, for various reasons, much greater. One of these reasons is the simple fact that part of the Community imports enter duty free, in which case tariff trade preferences do not represent a real benefit for the preferred country. In 1991 the share of duty-free imports[1] in total extra-EC imports amounted to 28,9%; these imports were concentrated in a limited number of countries or selected group of countries as can be seen from the following data. From Iran 89,5% of total imports entered the Community MFN duty free, followed by, in descending order, the GCC countries (83,7%), Iraq (81,1%), the Mashrek countries (77,1%), the former Soviet Union (67,3%), Venezuela (66,1%), the ACP countries (63,4%), Chile (63,0%), Australia (56,2%), Mexico (53,8%), and Canada (50,6%). Obviously, countries exporting predominantly oil and/or other raw materials to the Community face no or hardly any tariff barriers for their exports. The countries belonging to this group have, in the aggregate, that is ignoring certain specific products, a relatively low interest in preferential treatment in the Community market. On the other hand, countries like Taiwan (of which only 1,8% of total imports entered the Community duty free), Japan (2,6%), Romania (4,3%), South Korea (4,8%), Hong Kong (5,9%), the CACM countries (7,8%), China (8,0%), Turkey (8,4%), former Yugoslavia (8,7%) and the Asean countries (11,5%) are among the countries for which a relatively low share of their imports entered the Community duty free. These countries share, with some exceptions, a relatively strong (developing) specialization in manufactured exports. The countries belonging to this group have in general a significant interest in preferential treatment in the Community market.

After adding the duty-free share of imports of all partners qualifying for some form of preferential treatment to the imports from MFN sources, one obtains that in 1991 59% of all imports entered the Community on a non-discriminatory basis. However, the actual share of imports entering the Community on a non-discriminatory basis is even larger as not all imports from preferential sources entering the Community do actually receive preferential treatment. One reason for this might be the product exclusions in the relevant preferential scheme (for example agricultural products), another might be limitations on preferential treatment (preferential tariff quota, for example). Moreover criteria regarding the origin of the product (rules of origin requirements) have to be met, while also certain administrative requirements have to be fulfilled. For all this and other reasons the share of trade from preferential sources actually receiving preferential treatment is less than 100%, with a corresponding increase in the share of imports entering the Community on a non-discriminatory basis. Except in the case of the GSP (see also Section 5), there are no reliable estimates available as regards the extent to which preferential countries have actually utilized their trade preferences in their trade with the Community. Only in the case of the GSP it is known that about one-third of the dutiable imports actually receive preferential treatment, with the remaining two-thirds entering the Community on a non-discriminatory MFN basis. This, when added to the proportion calculated above, brings the share of imports entering the Community on a non-discriminatory basis to about 67%.[2] Adding to this percentage the imports from other preferential sources entering the Community on a non-discriminatory basis would yield a final, of course somewhat higher, figure of the share of imports in total extra-EC imports entering the Community on a non-discriminatory basis. It is clear that this figure could be well in excess of 70% of total extra-EC imports.

As regards the export side, it is clear that the Community receives relatively little trade preferences in its overseas markets. The principal markets where the Community receives preferential treatment are the EFTA countries, as well as the markets of the East and Central European countries with whom trade and cooperation agreements have been concluded. The Community receives also some preferences from Israel, Turkey, Malta and Cyprus. This suggests that at most one-third of the Community's exports receive some form of preferential treatment; in actual fact trade preferences extended to the Community pertain to a smaller part

[1] Note that duty-free imports are taken here to be represented by bound duty-free concessions, as well as autonomous duty-free concessions, but excluding agricultural products which carry a duty-free rate, but have at the same time a CAP charge applied to them. Excluded as well are temporary suspensions of duties on chemical and microelectronic products, implemented on the basis of Article 28 of the Treaty of Rome as amended by the Single European Act.

[2] In the case of the GSP, excluding the countries of Eastern and Central Europe, as well as the GCC countries, imports from GSP countries in 1990 amounted to ECU 91,3 billion, of which ECU 34,2 billion entered duty free. Of the dutiable imports of ECU 57,2 billion, ECU 18,4 billion actually received preferential treatment; consequently the remaining ECU 38,8 billion (8% of total extra-EC imports) entered the Community on an MFN basis.

of its exports, as not all exports are eligible for preferential treatment, or because the country concerned applies a zero tariff on an MFN basis.

5. The impact and utilization of preferential trading regimes

The theoretical comparative static impact of trade preferences is dealt with in detail in Box 1, while Box 2 provides some information on the impact of a concrete case of improved preferential access to the Community market, that is the extension of GSP preferences to the four poorest Andean countries; these preferences were extended by the Community for a four-year period, as a contribution to the fight against the production of drugs in these countries.

As regards the theoretical impact of trade preferences, it is important to underline that, in addition to the unambiguous beneficial trade creation effect resulting from a trade barrier removal, the trade diversion effect is of less importance in cases when the preferences reinforce an existing comparative advantage in a certain line of production. One could therefore argue that the multitude of trade preferences given to developing countries with broadly similar factor endowments, while undeniably causing some trade diversion for selected products, has in the first place acted as an incentive for these countries to increase their exports to the Community.

Box 1: The theoretical trade effects of preferences

Following Viner, in a comparative static framework, the effects of a preferential trade regime can be broken down into a trade-creating and a trade-diverting effect. The trade creation effect represents the additional imports from the preferred source as a result of the lowering of the landed price (import price plus customs duty) following the abolition or the lowering of the customs duty. The trade diversion effect represents the increase in imports from the preferred source at the expense of the traditional suppliers following the reduction or abolition of the customs duty on imports originating in the preferred country of supply. The lowering or abolition of duty causes an artificial lowering of the price of the preferred source in the market of the preference-giving country, inducing a switch in import procurement from the non-preferred country to the preferred country.

More formally, and as described in detail in Cline,[1] the trade creation and the trade diversion effects can be described as follows.

Assuming perfectly elastic supply trade creation equals:

$$\Delta M_i^{tc} = E_m \times M_i^p \times t$$

in which ΔM_i^{tc} is the trade creation effect, E_m is the price elasticity of import demand, M_i^p is the initial level of imports from the preference receiving country and t stands for the relative price change as a result of the abolition of the import duty on imports from the preferred country.

Trade diversion is estimated by the following formula:

$$\Delta M_i^{td} = \left[\frac{M_i^{np} \times M_i^p \times s \times t}{M_i^{tot}}\right] : \left[1 + \left(\frac{M_i^{np}}{M_i^{tot}} \times s \times t\right)\right]$$

in which ΔM_i^{td} is the trade diversion effect, M_i^{np} is the extra-EC imports of good i from non-preferred countries, s is the substitution elasticity and M_i^{tot} is the total extra-EC imports of good i.

Obviously the choice of elasticities (import elasticity and substitution elasticity) is crucial. In the absence of reliable empirical estimates, ranges of likely elasticities are often considered, which in turn results in ranges of possible outcomes of the trade

[1] Cline, W., Kawabane, N., Kronsjö, T. and Williams, T., *Trade negotiations in the Tokyo Round, a quantitative assessment*, Washington, 1978.

Percentage change in exports of preferred country as a result of a tariff preference (as a percentage of original exports)

	10% market share			20% market share			30% market share		
	−1	−2	−3	−1	−2	−3	−1	−2	−3
5% tariff	4,5	9,4	14,8	4,0	8,2	12,9	3,4	7,1	11,1
10%	8,9	19,6	32,5	7,8	17,0	27,9	6,8	14,6	23,6
15%	13,3	30,7	54,4	11,7	26,4	45,6	10,0	22,3	37,7
20%	17,6	42,9	81,8	15,4	36,4	66,7	13,2	30,4	53,8

creation and the trade diversion effects. On this basis the table above has been compiled which shows trade diversion (as a percentage of original exports of the preferred source), as a function of the original market share, the tariff (ranging from 5 to 20%) and the substitution elasticity S (ranging from -1 to -3).

The table shows clearly that the trade diversion effect is correlated with the substitution elasticity, as well as with the magnitude of the tariff preference. At the same time it can be seen that the trade diversion effect is inversely related with the market share of the country receiving the tariff preference; this simply reflects the fact that if trade preferences are given to countries which already have a relatively strong comparative advantage in certain products, the trade diversion effects will be relatively minor as such preferences simply reinforce an existing specialization pattern.

Box 2: Trade preferences in practice

Most trade economists are sceptical, if not negative, about the beneficial impact of trade preferences; this scepticism stems principally from concerns about the loss of economic welfare as a result of the misallocation of resources following the granting of discriminatory trade preferences. This is the so-called trade diversion effect. Another reason why trade preferences are viewed with scepticism is because often these preferences are limited, for example through tariff quotas, excessive restrictive rules of origin, and/or other (administrative) requirements preventing their effective utilization.[1] Moreover, it is often argued that trade preferences can be withdrawn at will by the donor, such as in the case of the GSP, which in turn discourages the countries benefiting from such preferences from making the investments necessary to take advantage of the preferences; in such cases the supply effect of the preferences are therefore nil.

While commonly the effects of preferences are analysed within the theoretical context of a comparative static framework (see Box 1), relatively little research has been done into the practical effects of such trade preferences. It was for this reason that the Directorate-General for External Relations of the European Commission decided to commission a study into the effects of the special preferences granted to Colombia and Ecuador. In 1990 the Community extended to these countries, together with Peru and Bolivia, on an exceptional and temporary basis (four years) additional GSP preferences, comparable to those granted to the least developed GSP-eligible countries, i.e. preferences not limited by tariff quotas (industrial products) combined with a much more liberal regime for agricultural products. It was argued that these preferences would assist these countries in their fight against drugs, as they would contribute towards the diversification of the domestic economies.

The study, carried out by the Institute of Development Studies at the University of Sussex (UK), of which the results are set down in a two-volume report entitled 'Study of the effects of the special tariff preferences extended to Colombia and Ecuador', reports in detail the development in trading relations between the Community and Colombia and Ecuador following the extension of these trade preferences. After a desk study phase, during which all the relevant statistics were collected and analysed, fieldwork was carried out in Colombia and Ecuador; interviews were held with over a hundred persons (manufacturers, exporters, representatives of employers' federations, ministries, etc.) in order to assess the impact of the improved preferences. On the basis of the study several valuable conclusions can be drawn.

Firstly, the additional preferences granted to Colombia and Ecuador had an impact on the trade performance of these countries in the Community market. However, 'anecdotal information ... suggests that from an EC (demand-side) perspective the principal effect has been trade diversion', that is to say, the increased exports of the preference beneficiaries have been at the expense of other exporters to the Community market.

Secondly, the short duration of the preferences (four years) prevents the associated supply effects (increased investment in competitive sectors) from materializing. The effectiveness of the preferences can be increased by granting them for a longer period.

Thirdly, the effects of the preferences were more pronounced in Colombia than in Ecuador, most likely as a result of the fact that the special preferences were introduced in Colombia at a time when the country introduced substantial economic reforms, leading to the opening-up of the economy. In contrast in Ecuador 'exporters ... had to obtain between 85 and 101 documents and between 232 and 254 signatures from 10 to 15 institutions, depending on the products, a process that takes between 125 and 138 hours'. Ecuador has since taken measures to streamline these procedures.

Fourthly, clear evidence exists that rules of origin, phytosanitary measures, standards and norms play a determining role in the eventual effective utilization of trade preferences. This seems to suggest that if trade preferences are to be effective, they should be embedded in a broader programme of trade cooperation.

[1] See, for example, Laird, S. and Sapir, A., 'Tariff preferences' in Finger, J. M. and Olechowski, A. (eds), *The Uruguay Round, a handbook on the multilateral trade negotiations*, World Bank, 1987.

As regards the effects of trade preferences in actual practice, the evidence appears to suggest (see Box 2) that trade preferences can be of assistance to developing countries, provided they implement the necessary supporting policies which foster macroeconomic stability and the participation of the country concerned in the world economy (trade policy, institutional framework, etc.).

As data on GSP utilization are by far the most comprehensive and elaborate, it is worth while to present the impact of the GSP scheme in somewhat greater detail. Some statistics on the actual utilization of GSP preferences are therefore provided in Table 19.

Table 19

GSP utilization in 1990 (in million ECU)

		As a percentage of dutiable imports
Total imports from GSP countries	112 494,2	
of which:		
non-dutiable imports:	43 430,2	
covered by GSP scheme:	49 147,2	71,2
of which:		
— sensitive products	27 079,6	39,2
— non-sensitive products	22 067,6	32,0
benefited from GSP preferences:	21 403,9	30,5
of which:		
— sensitive products	10 230,7	14,8
— non-sensitive products	11 173,2	16,2

Source: Eurostat and Commission services.

Table 19 shows clearly the impact of the GSP scheme on the EC imports from the countries concerned.[1] Of total dutiable imports, 71,2% was covered by the GSP scheme in 1990, and therefore in principle eligible for GSP benefits.[2] Of the dutiable imports covered by the GSP, more than half was classified as sensitive, that is products for which the GSP benefits are or can be limited under certain conditions.

Of the total dutiable imports about 30% actually benefited from GSP treatment in 1990; these imports therefore entered the Community duty free. Of the sensitive products covered by the scheme, about 38% actually benefited from GSP preferences, compared to 50% for the non-sensitive products. This shows indeed, as might be expected, that for sensitive products GSP benefits are more difficult to obtain. However, it is also interesting to note that for non-sensitive products the actual GSP utilization is relatively low, even though in this case no limitations are applied. Non-fulfilment of the rules of origin requirements could be at the cause of this phenomenon, as also could a lack of compliance by the exporting country with certain administrative requirements. Another reason which is often quoted for the low utilization of preferences for non-sensitive goods is the low tariff barriers applied to these products in the Community market, with hence very little incentive for utilizing potential GSP benefits.

Which countries have gained the most from GSP benefits? A comparison of the utilization of GSP statistics shows that in the 1980s there has been a considerable change in the countries benefiting from the Community's GSP scheme. While up to the mid-1980s oil-producing countries like Kuwait, Venezuela and Saudi Arabia were among the 10 most important beneficiaries of the Community's GSP scheme, in 1990, not a single OPEC country, with the exception of Indonesia, was among the top 10 beneficiaries of the Community's GSP scheme. The growing importance of China, accounting now for almost one-sixth of total GSP benefits, is noteworthy, as well as the importance of India. Table 20 provides some details with respect to 1990.

Table 20 shows that some very dynamic exporters belong to the group of top 10 beneficiaries of the Community's GSP scheme. Indeed some of them have shown a very rapid expansion in their exports to the Community; for example between 1980 and 1990 the average annual growth of imports in ecu terms amounted to 18,3% in the case of China, 12,5% for Thailand, 9,5% for Singapore and India and 7,5% for Hungary. Most of these countries have been very effective in utilizing GSP preferences, with a relatively high share in GSP benefits compared to their respective shares in dutiable imports. On the other hand there are also some dynamic exporters (Singapore and Hong Kong) which have a relatively low share in GSP benefits in relation to their share in dutiable imports; this reflects the consequences of the policy of differentiation.

It is also interesting to note that in the aggregate these top 10 countries benefited relatively more from the GSP (70,7% in total GSP benefits) than could be expected on the basis of their share in total dutiable trade (62%). This is partly

[1] Note that in 1990 both Hungary and Poland were included among the group of GSP beneficiaries.

[2] Although the Community's GSP scheme has, compared to schemes of other industrial countries, a relatively favourable, that is, broad, coverage, some products are excluded a priori (principally some primary products), while also only a limited number of agricultural imports are covered. Also products originating in coutries which have been graduated from the scheme are not included under the heading 'Covered by GSP scheme'.

Table 20

GSP utilization in 1990 (as a percentage of imports from all GSP beneficiaries)

	Share in dutiable imports	Share in GSP benefits	Share in GSP benefits, sensitive products	Share in GSP benefits non-sensitive products
China	13,5	17,7	15,2	20,1
India	4,9	9,4	13,7	5,4
Brazil	7,5	8,7	7,6	9,6
Thailand	5,4	6,7	7,3	6,2
Poland	5,9	6,4	3,0	9,6
Indonesia	3,3	5,2	6,5	4,0
Singapore	6,2	4,5	3,7	5,2
Malaysia	3,6	4,3	3,6	5,0
Hungary	3,8	4,2	2,5	5,8
Hong Kong	8,0	3,5	1,0	5,8
Total top 10	62,0	70,7	64,1	76,7

Sources: Eurostat and Commission services.

the result of the inclusion of China and, in particular India, among the top beneficiaries, countries which have been partly excluded from GSP graduation with respect to their textiles and clothing exports to the Community.[1] Another reason for the more than proportional share in GSP benefits of this group of countries appears to be the effective utilization of GSP preferences for non-sensitive goods by these countries (76,7% of the benefits for non-sensitive goods compared to a share in dutiable imports of only 62,0%). This seems to suggest that these countries have been more successful in developing the necessary infrastructure to take advantage of the benefits granted under the GSP.

6. Conclusions

The above analysis makes it possible to draw a number of conclusions, which can be summarized as follows.

Firstly, despite the importance of preferential trading relations for the Community, it is only for a relatively small share, less than 30%, of Community imports that the Community effectively extends trade preferences, despite the fact that a large majority of countries do benefit from some form of trade preferences in the Community market. On the export side, the Community receives preferential treatment for considerably less than one-third of its exports. These facts underscore the importance of the multilateral trading system for the Community, as well as for its trading partners.

Secondly, there is a tendency towards a growing importance of regional trading arrangements between the Community and its neighbours. The arrangements recently concluded with the EFTA countries and the countries of Eastern and Central Europe, as well as new arrangements under consideration with some of the Mediterranean countries and the GCC countries are examples of this. As regards the European countries, these arrangements are simply intermediate stages towards full membership of the Community.

Thirdly, trade preferences can work, but they can only be of minor assistance to the exporting country, especially when the overall level of protection in the export market is low, as is the case in the Community. If countries want to take advantage of trade preferences, they have to prepare themselves. Donors of trade preferences should assist countries in seizing the opportunities created by the extension of trade preferences. It also appears that countries where exports have been growing rapidly in the 1980s have been relatively effective utilizers of the benefits offered under the GSP.

Fourthly, provided the post-war trend of multilateral trade liberalization is not halted, the overall prospects for discriminatory trade preferences are not very bright. It is also for this reason, ignoring some exceptions, that the negative effects of trade preferences have been kept within acceptable bounds, as the tariff preferences offered under preferential schemes have been eroded as a result of multilateral trade liberalization.

[1] The regulation on differentiation with respect to textiles and clothing allows for 'adjustments' when 'the gross national product per capita of the country concerned is low and the country does not provided more than 5% of total Community imports of textile products and apparel'. Equally, an adjustment can take place in the case that 'the total textile exports of the country concerned comprise almost exclusively a single product'.

III — The developing countries in the 1980s

B — A variable growth and trade performance

During the 1980s the growth of the world economy slowed down markedly compared to the performance recorded for previous years. Thus world output growth averaged 3,2% at an average annual rate in the decade to 1990 compared to 4% in the 15 years to 1980. This slowdown was experienced in the industrialized world (for the OECD area the equivalent figures are 3,1 and 3,7% respectively) and also, to a much greater extent, in the developing world where for low and middle income countries[1] growth slowed down to 3,6% per annum from the very impressive 5,9% registered for the earlier period.

Details of this growth performance, for broad groups of developing countries, are set out in Table 21. However it will be seen from this table that not all groups of developing countries participated in the growth slowdown recorded at the aggregate level. Thus vigorous growth was maintained in East Asia (which includes China) and a marked acceleration was observed in South Asia. In contrast growth rates in Latin America and North Africa dropped dramatically. Indeed Table 21 suggests that the variation in growth performance over the period 1980-90, between various groups of developing countries, was much greater than the variation observed over the previous 15 years. This increase in the diversity of developing countries' performance is a major theme of this part of the report.

Table 21

GDP growth rates 1965-90
(average annual rates)

	1965-80	1980-90
Low and middle income countries	5,9	3,2
of which:		
Sub-Saharan Africa	4,2	2,1
East Asia (including China)	7,3	7,8
South Asia	3,6	5,2
North Africa and the Middle East	6,7	0,5
Latin America	6,0	1,6
OECD	3,7	3,1
World	4,0	3,2

Source: World Bank.

[1] There are a number of ways in which the group 'developing countries' can be defined. One possible definition is to take all countries in the world less the OECD countries and less the former Eastern Bloc countries. This, broadly speaking, is the UN approach. However, this definition, like all definitions, leads to certain anomalies and the World Bank takes a different approach and classifies countries by income per head. The group 'low and middle income countries' covers the developing countries defined as above but excludes certain of the oil-producing States of the Gulf, Hong Kong, Singapore and Israel, and includes China and the former East European countries of the Eastern Bloc. Cuba, North Korea and the States of the former USSR are excluded.

Most commentators on these developments point to a range of factors to account for this significant change in performance. The second oil-price shock of 1979-80 and the policy response of industrialized countries to the substantial increase in the relative price of oil led, in many cases, to a sharp and painful period of adjustment and declines in demand and output. At the same time tensions between monetary and fiscal policy in the United States of America led to a sharp rise in real interest rates world-wide and a marked upward movement in the value of the US dollar. Thus, in the opening years of the 1980s, developing countries received three contractionary shocks — higher oil prices, a drop in demand from the industrialized world and rising real interest rates. Faced with these shocks many developing countries were unable to repay or even service the debts they had accumulated in earlier years when expectations of ever rising oil prices had encouraged borrowing and lending on a scale which, in hindsight, seems imprudent. These developments led to the Third World debt crisis which threatened at one stage to damage seriously the world financial system. It is a matter of record that Latin America, sub-Saharan Africa, and North Africa were and remain particularly affected by the debt crisis.

Table 22

Growth rates of GDP per head
(average annual rates in volume terms)

(%)

	1960-80	1980-90
Sub-Saharan Africa	0,8	−0,9
East Asia (including China)	4,2	6,3
South Asia	1,3	3,1
North Africa and Middle East	4,6	−0,5
Latin America	2,8	−0,5

Source: World Bank.

Given the relatively vigorous rates of population growth observed in most of the developing world it is also clear that rates of growth of output per head have slowed down markedly in the past decade.

In particular, as Table 22 shows, levels of output per head in 1990, in North Africa and the Middle East, Latin America, and in particular sub-Saharan Africa, were only 95 and 91% respectively of their 1980 levels.

An examination of Table 23 in conjunction with Table 21 makes it possible to see to what extent export performance is linked to output growth. Thus the slowdown in world

export growth from 6,6% per annum in the 15 years to 1980 to 4,5% in the 10 years to 1990 was also reflected in the performance of the OECD economies where export volume growth dropped sharply. However, in the developing world very diverse patterns of export growth were recorded.

Although export growth virtually disappeared in sub-Saharan Africa and fell markedly in North Africa and the Middle East (partly a reflection of developments in the oil market), East Asia remained a dynamic exporting zone and South Asia produced a remarkable performance. Much of this growth was concentrated in the second half of the decade and can partly be explained by the success of the Ghandi reforms in India (by far the largest economy in the area) which set out to liberalize the import regime faced by Indian producers, particularly in the textiles sector, so enabling them to specialize more and achieve substantial productivity gains which were reflected in prices.

Moreover, Latin American exports also pushed vigorously ahead a development reflecting in part the severe internal domestic demand squeeze and the associated internal and external structural adjustments undertaken, as the Latin American countries sought to tackle the debt crisis.

It can be argued that Tables 21 and 23 provide evidence in support of the general notion that a country's trade performance and growth performance are correlated in a positive way.

On the theoretical side a positive link between output growth and export growth can be demonstrated provided two conditions are fulfilled.

Thus, economic growth will be favoured in those countries that provide for the efficient allocation of production resources and for access to inputs, capital and technical know-how on the best possible terms. This points to the need for an economy to be open. In an open economy producers are subject to the full force of competition but, at the same time, enjoy complete access to goods and services, technology, investment and other capital flows. However, to benefit fully from such openness, trade as well as tax and pricing policies need to be neutral as regards external versus internal supplies of goods, services, technology and investment. Such undistorted access enables producers to use efficiently competitively priced resources so raising total factor productivity. In turn the stimulus of external competition ensures that productivity gains keep up with those of major competitors. Thus, undistorted openness and gains in productivity are likely to be positively correlated.[1] Moreover an open economy is one that will be better able to adapt to changes of circumstance and put into effect necessary structural reforms.

Productivity growth benefits the economy as a whole by making it more competitive both internally and externally. Greater internal competitiveness favours all producers and so stimulates overall GDP growth. Greater external competitiveness favours production for export in an open, undistorted economy.

Table 23

Export growth rates 1965-90
(average annual growth rates in volume terms)

(%)

	1965-80	1980-90
Low and middle income countries	4,1	4,1
of which:		
Sub-Saharan Africa	6,1	0,2
East Asia (including China)	8,5	9,8
South Asia	1,8	6,8
North Africa and Middle East	5,7	−1,1
Latin America	−1,0	3,0
OECD	7,2	4,1
World	6,6	4,3

Source: World Bank.

Hence, in an open, undistorted economy vigorous output and export growth are likely to be correlated.

However the term correlated does not exclude the possibility that, in certain economies which are in many aspects closed, and which also have non-neutral trade regimes, output and export growth can still be vigorous and can move together.

A range of evidence in favour of this output growth/export growth hypothesis has recently been examined by the World Bank).[2] In considering this evidence the World Bank concludes that:

'The export gains of developing countries from trade liberalization appear to be large... . Recent studies show that trade and growth are positively associated .... Higher shares of exports in GDP have a close association with higher productivity growth ... although the causal direction of this association is unclear.'

[1] See *World development report 1991*, p. 100.

[2] *Global economic prospects and the developing countries*, 1992.

Assuming that such a link is established, and setting aside for the moment the question of the direction in which the forces of causality move, this link between output and trade can be expressed in a formal way via the calculation of trade elasticities. Such elasticities are defined as the growth of export volumes associated with a growth of output volumes. They can be calculated for the world as a whole (thereby indicating, for the longer term, how much world trade can be expected to grow given an increase in world output or, to put the causality in the other direction, how much world trade needs to grow to ensure a given increase in world output), or on a regional basis.

Firstly, considering the 25-year period from 1965 to 1990, as covered by Tables 21 and 23, a range of elasticities can be calculated. These are set out in Tables 24 and 25.

Table 24

World trade elasticities 1965-90

	GDP growth rates	Export growth rates	Export[1] elasticity
Low and middle income countries	5,0	4,1	1,10 (1,29)[2]
of which:			
Sub-Saharan Africa	3,4	3,7	1,00 (0,10)
East Asia (including China)	7,5	9,0	2,43 (3,06)
South Asia	4,2	3,8	1,03 (2,13)
North Africa and Middle East	4,8	3,0	0,81
Latin America	4,2	0,6	0,16 (0,94)
OECD	3,5	6,0	1,62 (1,28)
World	3,7	5,7	1,54 (1,34)

[1] With respect to world trade.
[2] Figures in brackets refer to the period 1980 to 1990.
Source: World Bank.

Tables 24 and 25 make it possible to illustrate the question of export growth/output growth causality from different points of view. Thus, to the extent that it is world activity (dominated by the OECD) that pulls developing countries exports along, then Table 24 shows that over the 25 years to 1990 it was East Asia that responded most dynamically to this pull and Latin America most sluggishly. Alternatively it is in the main the OECD and East Asian countries that have been best able to exploit the link between export growth and output growth via the multilateral trading system. The Latin American countries, in contrast, have depended more on internal developments to generate output growth.

These observations are reinforced by the elasticities set down in Table 25 where the figure for the OECD shows, albeit in a different way, that world trade is dominated by the OECD's trade with itself. Once again the rate of growth of exports in Latin America appears to have a relatively modest impact on the rate of growth of output (or alternatively growth generated in the domestic sector spilled over only to a limited extent into trade). For the other developing regions, by and large, exports advanced at broadly the same pace as out-put.

Table 25

Regional trade growth elasticities 1965-90

	Export/GDP growth rate
Low and middle income countries	0,82
of which:	0,82
Sub-Saharan Africa	1,09
East Asia (including China)	1,02
South Asia	0,90
North Africa and Middle East	0,81
Latin America	0,43
OECD	1,71
World	1,54

Source: World Bank.

The final column in Table 24 shows that the variations in the response of the growth of exports to an expansion of world output, as between the different developing country regions, has been even more marked in the last decade. East and South Asia were well ahead of the rest, but the performance of sub-Saharan Africa was particularly poor and that for North Africa and the Middle East not better.

The above discussion illustrates the way in which, in matters of growth and trade, developing country regions have performed very differently over the decade to 1990. However, another feature of the global economy, over the last decade, has been the liberalization of capital movements of all kinds, by both industrialized and developing countries. These moves towards a more open liberal capital regime, which gathered pace towards the end of the decade, have implications for the relative importance of investment and trading links between the developed and developing world.

Thus, as the constraints on foreign direct investment (FDI) and related flows (profits, interest, dividends, etc.) are removed, then replacing direct trade by direct investment for certain countries, for certain sectors and for certain production activities becomes more attractive. In particular when capital and related flows are unconstrained trade and

investment can become substitutes in a way that is impossible when capital movements are subject to control.

The liberalization of capital movements is one aspect of the major development policy reforms which many developing countries have undertaken in the 1980s.

Thus, although, as already noted, many developing countries have spent much of the past decade struggling with their external debts, the debt problem itself, combined with the spectacular economic success of a number of South-East Asian economies, has been the catalyst for marked changes in the economic policy stance of many developing countries.

Thus, the conclusion drawn by many from the success of South-East Asia is that development is best served by an economic policy mix that favours export growth based on open, undistorted markets and not by policies that promote import substitution particularly via protectionist measures. By following the former approach a number of South-East Asian economies have been able to exploit the dynamism generated by world trade in manufactured goods, despite the fact that certain sectors of particular importance to developing countries (textiles) are subject to fairly onerous restrictive regimes (the MFA).

As regards the debt crisis a number of middle income developing countries, particularly in Latin America, now take the view that the best way to overcome this crisis is for the economic governance of the countries concerned to be placed on a sound footing, firstly by ensuring that the major macroeconomic disequilibria are tackled and secondly by ensuring that at the microeconomic level, markets are as open, free and undistorted as possible. In this way growth is stimulated, foreign direct investment and other forms of finance are encouraged, flight capital returns and the debt burden becomes more manageable. A number of Latin American countries (Mexico, Chile, Uruguay and Argentina) are embarked on this path. A number of others are beginning to follow the same route (e.g. India).

It would be expected therefore that the liberalization of capital movements in the 1980s combined with other reforms being undertaken in the developing world would lead to a substantial expansion in the flows of direct foreign investment from developed to developing countries particularly towards the end of the decade. This expectation is broadly confirmed by the aggregate data.

To begin with a recent study by the United Nations[1] shows that between 1985 and 1989 total outflows of foreign direct investment virtually quadrupled. This amounts to an average annual increase of almost 40% at a time when the value of world trade was increasing by about 10% per year in nominal terms. However, a substantial part of the increase was accounted for by flows of foreign direct investment between developed countries. The increase in outflows of FDI to the developing countries was more modest. None the less, the increase was by no means insignificant and does suggest that the efforts at reform being undertaken by developing countries, and described above, are beginning to bear fruit. Thus according to DAC data total FDI flows from DAC members to developing countries, which fell to an annual average of USD 12 billion in the early 1980s, had risen to an annual average of USD 25 billion by the end of the decade.

Preliminary statistical evidence also suggests that the European Community has contributed to this change. Thus, in the mid-1980s the six European Community Member States particularly involved in FDI in developing countries (France, Germany, Italy, the Netherlands, Spain and the United Kingdom, an aggregate that might be termed the EC-6) accounted for an FDI flow to the developing world of about ECU 6 billion (about USD 4,5 billion). By 1989 this had increased to ECU 8,5 billion (about USD 10 billion). None the less the available evidence also suggests that this outflow fell sharply in 1990 possibly reflecting the negative impact of the invasion of Kuwait on investor confidence combined with the strengthening of recessionary forces in certain European countries.

A further analysis of the available data shows that the most important destinations of FDI from the European Community (EC-6) were the countries of South-East Asia and Latin America. The latter accounted for 35% of the total for the period 1988-89 (57% in the period 1984-85). Thus, the strength of the FDI flow to Latin America appears to have been broadly maintained during a period when these countries were struggling to overcome the debt problem. South-East Asia was also a most important destination — 38% of the total for the period 1988-89, 32% in the period 1984-85).

In contrast investment by the EC-6 in other developing regions — the ACP countries, South Asia, the Mediterranean and the Middle East — was very modest indeed, although FDI flows to the developing countries of the Mediterranean basin appear to have strengthened somewhat in recent years (11% of the total in 1988-89). Moreover, in 1989 (and also in 1990) investment in the oil sector in certain oil-producing States in Africa appears to have been particularly strong. Investment from EC-6 in South Asia has remained very weak indeed.

[1] *World investment report 1991*, 'The triad in foreign direct investment', UNCTC, July 1991.

Overall therefore, although the structure of FDI by European countries appears to favour those countries that already apply policies that encourage open market oriented development, or are in the process of introducing such policies, there is as yet no clear evidence of a substantial increase in the level of FDI in response to the reforms already taken or under way.

It is also interesting to consider to what extent the variations in performance of the 1980s are likely to persist into the future. As regards the outlook for the developing countries for the present decade a number of factors are likely to repress growth. Thus,

(i) it will be some time before the rate of growth in the major industrialized countries regains the momentum observed in the second half of the 1980s. A number of factors may be advanced to account for this — the persistence of budgetary disequilibria in the United States, the costs of German reunification, a general lack of confidence resulting from the feeling that the world has entered a somewhat uncertain and turbulent era (the unresolved tensions in the Middle East and all the problems the Gulf War failed to solve, the civil war in Yugoslavia, rising tensions in the ex-USSR, the uncertainties of European integration, the massive environmental problems confronting the human race and the apparent inability or unwillingness to solve them);

(ii) the likelihood that real interest rates will remain high for some time to come, the result in part of the persistence of inflationary pressures, and in part of the need to call forth adequate savings to finance the massive capital needs of reconstruction in the East (not to mention Yugoslavia, Kuwait and Iraq) and of the need to tackle the world's environmental problems;

(iii) the unfinished Uruguay Round, leading to the possibility that the world may split into competing trading blocs with all that might imply for the inefficient use of resources and the loss of welfare;

(iv) continued commodity price weakness;

(v) a shortage of concessional finance (e.g. aid) for the developing world. Indeed there is little sign that the donor community will be more generous in the decade ahead, as regards concessional development finance, than it was in the past 10 years.

Set against these negative factors are the following positive factors:

(i) a large number of developing countries are pressing on with economic reforms which should substantially enhance their prospects for output and export growth. However, it can be argued that matters are delicately balanced here in that many developing countries consider the pains and sacrifices resulting from economic reform only worthwhile if developed countries are willing to lower tariffs and abolish non-tariff barriers to developing country exports, steps which the advanced industrial world appears reluctant to take (as revealed for example by the stalled Uruguay Round negotiations);

(ii) for a number of the former Eastern Bloc countries it can be argued that the worst aspects of the post cold war adjustment process may now be over with the most marked contraction in output (as these countries adjusted to the breakup of Comecon and the full threat of market forces) occurring in 1991. In the years ahead the outlook is for an expansion of output and exports by these countries with consequent benefits for all participants in world trade.

On the basis of these considerations a recent study by the World Bank[1] presents a very optimistic picture of output and export growth for the developing countries to the year 2000. In making these forecasts the World Bank clearly gives weight to the impact of economic policy reforms on output and trade. The World Bank picture as regards output growth is set out in Table 26.

Table 26

The outlook for GDP growth (average annual growth rates)

(%)

	1980-90	1990-2000
Low and middle income countries	3,2	4,9
of which:		
Sub-Saharan Africa	2,1	3,5
East Asia (including China)	7,8	7,1
South Asia	5,2	5,0
North Africa and Middle East	0,5	4,5
Latin America	1,6	4,2
G7 countries	2,8	2,6

Source: World Bank.

[1] *Global economic prospects and the developing countries*, 1992.

The recovery foreseen for North Africa and the Middle East and for Latin America is particularly marked.

As Table 27 shows this improvement in output is expected to depend to a substantial extent on stronger export growth combined with a trend to an increased share of manufactured goods in total exports — a trend from which all developing countries are expected to benefit including sub-Saharan Africa. It is therefore the dynamics of international trade in manufactures that are expected to play a key role in enabling poorly performing developing regions to recover.

Table 27

The outlook for export growth (average annual growth rates)

(%)

	1980-90	1990-2000
Low and middle income countries	4,1	7,0
of which:		
Sub-Saharan Africa	0,2	3,6
East Asia (including China)	9,8	9,8
South Asia	6,8	7,8
North Africa and Middle East	−1,1	4,9
Latin America	3,0	4,9

Source: World Bank.

Overall Tables 26 and 27 point to the possibility of some modest convergence in the economic performance of the various developing country zones between now and the end of the century.

Moving on from these more general considerations it is perhaps useful to examine the importance of the European Community as a market for developing country exports over the last decade. Thus, according to World Bank data, in 1989 total exports of the developing countries amounted to USD 713 billion, of which some USD 148 billion went to the European Community (21% of the total) as compared to USD 165 billion to the USA (24% of the total) and USD 90 billion to Japan (13%).

In 1980 the figure, even at the current US dollar rate, was somewhat greater — USD 156 billion.

As Table 28 shows this fall is more than accounted for by the marked drop in the value of Community oil imports. Excluding oil, developing country exports to the Community increased from USD 58 billion in 1980 to USD 111 billion in 1989. Table 28 also shows the striking increase in imports of manufactured goods from 15% of the total in 1980 to 48% in 1989.

Eurostat data covering Community imports from developing countries and valued in ecus puts the proportion of manufactured imports in total Community imports from the developing countries at 44% in 1989 and virtually the same in 1990. The difference between these two proportions for 1989 (44% as opposed to 48% using World Bank data) may be accounted for by differences of valuation and coverage (cif/fob) and geographical and product definitions. None the less both sets of data confirm the fact that, by the end of the last decade, virtually half of the Community's imports from developing countries were of manufactured goods of which one-third was accounted for by textiles.

Table 28

Commodity composition of developing country exports to the European Community

(billion USD, percentages in brackets)

	1980	1989
Primary commodities	133 (85)	77 (52)
Fuels	98 (63)	37 (25)
Agriculture and food	8 (5)	10 (7)
Other	25 (17)	30 (20)
Manufactured products	23 (15)	71 (48)
Textiles	11 (7)	22 (15)
Total	156 (100)	148 (100)

Source: World Bank.

This particular feature of the Community's foreign trade reflects in part the success the East Asian countries have had in increasing their share of the Community market. Table 29 shows how this share has increased over the period since 1980. In particular trade with East Asia is now as important as trade with North Africa and the Middle East, a zone which has, in the past, dominated the Community's imports from the developing world because of its importance as a supplier of oil. However the Gulf countries of the Middle East still provide 14% of total fuel imports. Thus two features of Table 29 are of particular interest — the decline in the contribution of the Middle East oil-producing States to Community imports from developing countries and the increasing importance of East Asia of which South-East Asia accounts for a major share.

It is because of these marked changes in import structure that the remainder of this section is devoted to an assessment of developments in South-East Asia, North Africa and the Gulf States.

Table 29

Geographical origins of Community imports from developing countries

(as percentage of ECU values)

	1980	1989	1990
ACP	17,3	14,5	10,6
East Asia	15,3	32,4	32,4
of which:			
South-East Asia	6,3	10,4	11,1
South Asia	2,5	4,4	4,7
North Africa and Middle East	52,7	30,8	32,2
of which:			
Middle East	47,2	17,8	18,0
Latin America	12,2	17,7	16,5
Total	100 (109,1)	100 (146,5)	100 (153,0)

Figures in brackets relate to billion ECU.
ACP: the coverage of this aggregate is close to that of sub-Saharan Africa.
East Asia includes China. Separate data for China (billion ECU) are:

	1,9	9,1	10,6

South-East Asia includes Asean, plus Burma plus Indo-China. It should be noted that the last two countries play only a limited role in international trade.
Middle East excludes former Yugoslavia and Turkey for which data in billion ECU are:

Yugoslavia	2,2	7,1	7,7
Turkey	1,1	5,5	5,9

Source: Eurostat.

1. The dynamic Asian economies

The 1980s saw a group of dynamic economies in South-East Asia emerge as major players in the world markets. In contrast to the rest of the developing world for Hong Kong, Malaysia, Singapore, South Korea, Taiwan and Thailand, the 1980s were a decade of opportunity.

With growth rates of 7% per annum in the period 1983-89 these economies, which have come to be known as the dynamic Asian economies (DAEs), outperformed their Western counterparts by a healthy margin. By 1989 they accounted for 6% of global GDP as against Japan's 24%. Their share of the world market for manufactured goods amounted to 21% in that year, in comfortable range of Japan's 24% and the Community's 26%.

Preliminary data for 1990 and 1991 suggest that their share of the market for manufactures continued to increase in those years.

The spectacular growth of these economies is a reflection both of their competitiveness and of the commitment of their governments to business-oriented policies. Private sector driven development, backed by high public sector investment in physical and institutional infrastructure, created an investor-friendly environment. Successful restructuring policies have moved production towards capital-intensive and high technology based activities. The composition of exports shifted towards technologically sophisticated products destined for the markets of the industrialized world.

By 1989 five of the DAEs ranked amongst the top 25 exporters at the global level.[1] The same nations also ranked amongst the world's 25 top traders in commercial services. Japan has become the group's principal trading partner, a phenomenon which, whilst partly reflecting physical proximity, is in some measure the natural consequence of the sharp increase in Japanese investment in those countries during the latter part of the 1980s.

Japan's share of their exports rose from just under 12% at the beginning of the decade to 22% by 1990. Japanese exports to the DAEs likewise rose, although less sharply. At the beginning of the 1980s they accounted for a little over 21% of the total. By the end of the decade they stood at almost a quarter of the total.

Table 30

Total increase in exports 1984-90

(%)

From	To		
	EC	US	Japan
Malaysia	101	95	22
Singapore	249	145	101
South Korea	259	92	178
Taiwan	281	48	165
Thailand	239	292	299
Hong Kong	84	12	158

Source: Eurostat.

Trade with the European Community as a proportion of total trade increased slightly. Imports from the Community rose from 10,4% of total imports in 1982 to 15,3% in 1990; exports to the Community rose from 13,8% in 1982 to 15,4% in 1990. Exports of manufactures dominated the DAEs' trade with the Community. Almost 90% of these nations' exports to the Community fell into this category in 1989: a decade previously the proportion was 69% .

[1] These were Singapore, South Korea, Taiwan, Thailand and Hong Kong.

Exports of food and primary materials, on the other hand, accounted for as much as 20% of total American exports to the DAEs in 1989. The relatively high share of non-manufactures in the American exports has contributed to the deterioration of the US trade balance with the DAEs from USD 6,9 billion in 1982 to USD 36,3 billion in 1989, whereas in the case of Japan this effect has worked in the opposite direction and partly accounts for the increase in the latter's surplus from USD 12,4 billion in 1982 to USD 30,6 billion in 1989.

Exports of foodstuffs were of rather greater importance in the case of Japan, where they accounted for almost 17% of the DAEs' total exports to that country, but in the case of Japan too manufactured goods accounted for about 60% of total exports. For all three major trading partners commodity exports declined sharply in relative importance during the 1980s.

Success in the external markets was a major factor underlying the strong growth of these economies over the past decade. Growth rates were highest in South Korea and Taiwan. In the decade 1981-90 these economies achieved annual growth rates of 9,9 and 8,5% respectively. Thailand and Hong Kong recorded rates of expansion of 7,8 and 7,1% over the same period. For Malaysia and Singapore economic expansion proceeded at an impressive 5,2 and 6,3% respectively.

Table 31

Total increase in imports 1984-90

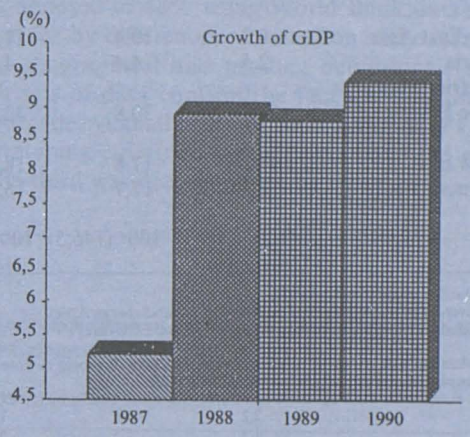
(%)

From	To		
	EC	US	Japan
Malaysia	104	87	92
Singapore	162	121	132
South Korea	336	147	142
Taiwan	305	138	158
Thailand	314	186	276
Hong Kong	168	123	99

Source: Asian Development Bank.

Yet although these economies share a history of achievement in the 1980s structurally they are far from homogeneous. Hong Kong and Singapore, though possessed of major manufacturing sectors, are first and foremost significant as regional centres offering a wide range of financial and trade facilitation services. South Korea and Taiwan are major manufacturing centres. Malaysia and Thailand retain an important agricultural sector. Rather the similarities lie in high savings rates, high investment and strong export performance.

GRAPH 13: **Malaysia — Basic data**



Population (1990): 18 million
GDP per capita (1989): USD 2 130

Sectoral share of GDP (1990):

Agriculture:	19,4
Industry:	41,7
Services:	38,9

Source: Asian Development Bank.

Saving as a proportion of GDP has been high, even by Asian standards. Over the decade 1981-90 the proportion of GDP saved annually ranged from a high of 42% in Singapore to a 'low' of 24,5% in Thailand. The equivalent figures for Japan and the United States in 1990 were 20 and 3,2% respectively. Savings as a proportion of GDP in the EC amounted to 21,1% in 1990.

A number of factors contributed to these rates of saving, not least of which were relatively stable currencies, low inflation and social services which emphasized the virtues of self-reliance.

This savings-friendly environment was in many instances enhanced by official intervention. In Singapore the government-sponsored Central Provident Fund has been a major medium through which savings have been mobilized. In Taiwan public policy has favoured the saver through a combination of incentives, e.g. tax exemptions on term deposits, backed by penalties for the profligate, e.g. taxes

on luxury and leisure goods. In Malaysia the Employees Provident Fund, and in lesser measure the National Savings Bank and the National Unit Trust, have provided channels through which savings, particularly those of the small savers, have been mobilized for development.

The strong savings performance has been mirrored by a sustained upward trend in investment. In the decade 1981 to 1990 investment as a proportion of GDP ranged from a high of 42% in Singapore to a 'low' of 20% in Thailand. The equivalent figures for Japan and the United States in 1990 were 32,1 and 16,6% respectively. In the EC investment as a proportion of GDP was 20,8% in 1990.

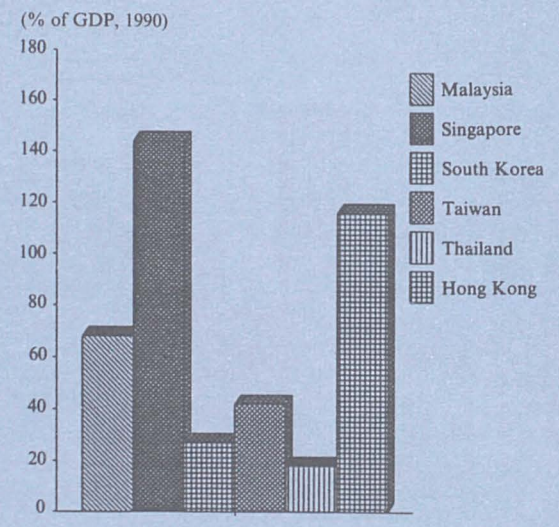
In all the countries covered there was, in greater or lesser measure, a focus on upgrading production facilities together with a shift towards less labour and more technology-intensive industries. Singapore focused strongly on the chemical and petrochemical industries in the mid-1980s. By the late 1980s the focus had shifted towards computers and electronics which in their turn appear likely to be displaced by biotechnology and informatics-based industries by the mid-1990s.

In Taiwan the food and beverage industries which had been the mainstay of the manufacturing sector in the early 1980s have given way to the plastics and electronics industries.

Taiwan is now a major producer of television sets, computer monitors, electronic calculators and audio equipment. In Korea consumer electronics, integrated circuit boards and computer peripherals have displaced the traditional textile and clothing industries as the mainspring of growth.
Developments in Malaysia typify the growth pattern of the South-East Asian economies. Over the last two decades Malaysia has moved from dependence on a limited range of primary commodities to become one of the faster growing manufacturing economies of the region. A radical revision of the country's foreign investment rules, reorientation of policy from import substitution towards the exploitation of export opportunities and a rigorous pruning of loss-making public sector enterprises underlie the turn-about in the nation's economic profile. In common with other fast-growing economies Malaysia's positive approach towards human resource enhancement and the consequent availability of a well-educated workforce has been a significant factor in enabling the country to avail of the opportunities offered by the increasing mobility of investment.

Foreign investors played a significant role both in the diversification of industrial structures and in facilitating technology transfer.

GRAPH 14: **DAEs — Merchandise exports**



Source: Asian Development Bank.

GRAPH 15: **Singapore — Basic data**

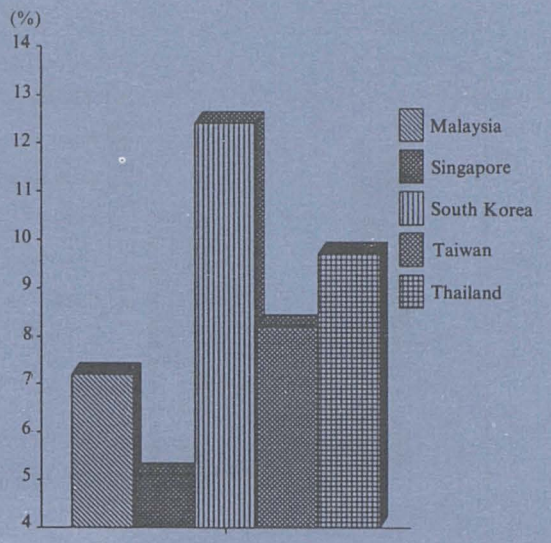
Population (1990): 2,8 milllion
GDP per capita: USD 10 450

Sectoral Share of GDP (1990):

	(%)
Agriculture:	0,3
Industry:	35,9
Services:	63,8

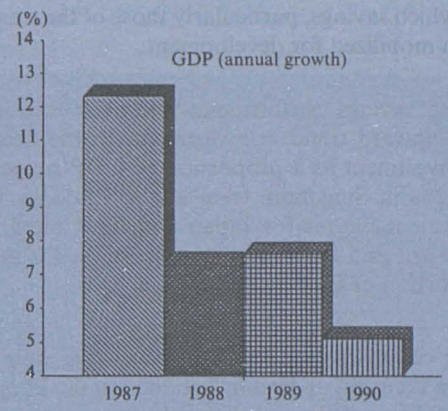
Source: Asian Development Bank.

GRAPH 16: **DAEs — Growth of value-added in industry (annual average (1981-90))**



Source: Asian Development Bank.

GRAPH 17: **Taiwan — Basic data**



Population (1990): 20,2 million
GDP per capita: USD 7 510

Sectoral share of GDP:

	(%)
Agriculture:	4,2
Industry:	43,3
Services:	52,3

Source: Asian Development Bank.

This phenomenon is particularly marked in those economies which also form part of Asean (i.e. Malaysia, Singapore and Thailand). In Singapore foreign investment has been a major factor underlying the economy's rapid expansion. During the period 1985 to 1990 foreign investors, amongst whom US and Japanese enterprises predominated, accounted for 84% of total investment in manufacturing industry. The bulk of that investment was in high-technology sectors such as chemicals, petrochemicals and electronics.

Malaysia has likewise benefited from a strong inflow of investment from abroad, principally from Japan and Taiwan, in the latter part of the 1980s. Thailand, the third of the Asean nations, has profited from the relocation strategies of the major Japanese corporations. Japan's direct investment, estimated to account for a quarter of total foreign investment in Thailand, rose from ECU 108 million in 1986 to ECU 1,04 billion in 1990.

Investment by the Community nations has been significant. A recent survey of the six major investor nations[1] commissioned by the Community indicates that investment totalled ECU 5,2 billion in the period 1987-90. Investment was highest in the industrial and primary sectors which accounted for 63 and 21% of the total respectively.

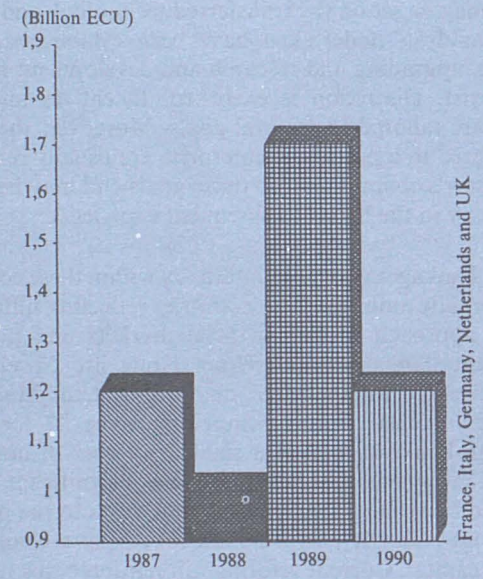
[1] Germany, France, Italy, the Netherlands, the United Kingdom and Spain.

The survey does not permit direct comparison with inflows from the United States and Japan, nor are such comparisons easy to draw from alternative sources. A survey of investment in Malaysia, Singapore and Thailand over the period 1987-89 conducted by the EC-financed Joint Investment Councils suggests that the Community trailed Japan and the United States in terms of direct investment.

But these figures tend to understate the strength of the European presence. Unlike its competitors, much of the Community's investment tends to be indirect, channelled through subsidiaries domiciled elsewhere in the region and thus 'hidden' in official statistics. Europe's historical presence in South-East Asia, dating virtually without break from the 17th century, lends force to this argument.

Whilst the enviable record of these countries in attracting foreign investment can be attributed in large measure to the business-friendly orientation of public policy, there has been a certain *dirigiste* element in the formulation and implementation. In all countries forms of indicative planning have been established and, in greater or lesser measure, institutional structures have been set up to develop sectoral strategies and provide guidance and support to the business community.

GRAPH 18: EC direct investment in DAEs

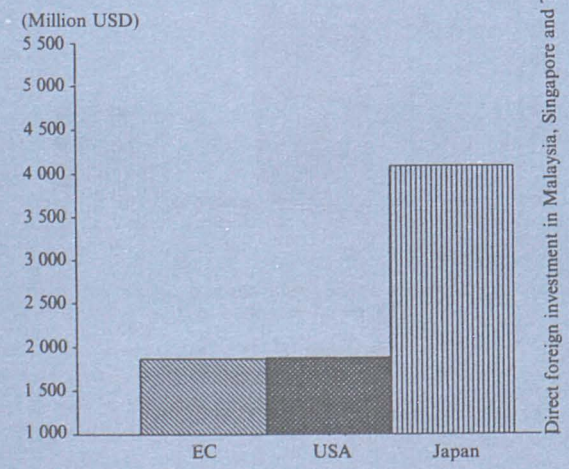


Source: EC Commission.

Not all countries have carried these measures quite as far as the Korean authorities, who, influenced by Japanese models, have established the Kotra (Korean Trade Promotion Cooperation), a clone of Japan's formidable Jetro, to undertake market research and promote exports, activities in which it has achieved remarkable success. The authorities have also encouraged the formation of general trading companies, the *chaebol,* along the lines of the Japanese *Sogo Shosha,* to which they accorded fiscal privileges.

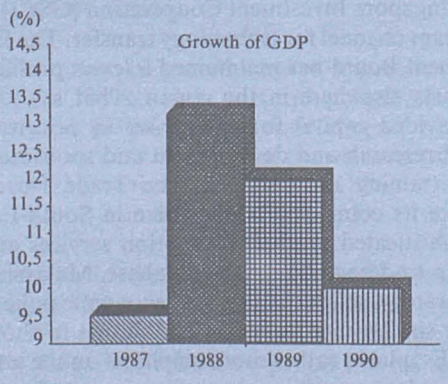
Taiwan's approach has been less overtly centralized than that of South Korea. None the less a certain resemblance may be discerned. Cetra, the Taiwanese trade promotion agency, maintains a sophisticated database on export opportunities, acts as a highly effective market research institute and organizes participation in trade fairs. Publicly aided producer and exporter association libraries provide a reliable source of information for local enterprises. Research and development is supported by the Industrial Technology Research Institute. At the mezzanine level, the Industrial Development Bureau transforms the indicative plan into detailed sectoral working plans, identifies products which 'merit' fiscal incentives and provides Japanese-style 'administrative guidance'.

GRAPH 19: DAEs — Investment by origin (1986-89)



Source: EC Commission.

GRAPH 20: Thailand — Basic data



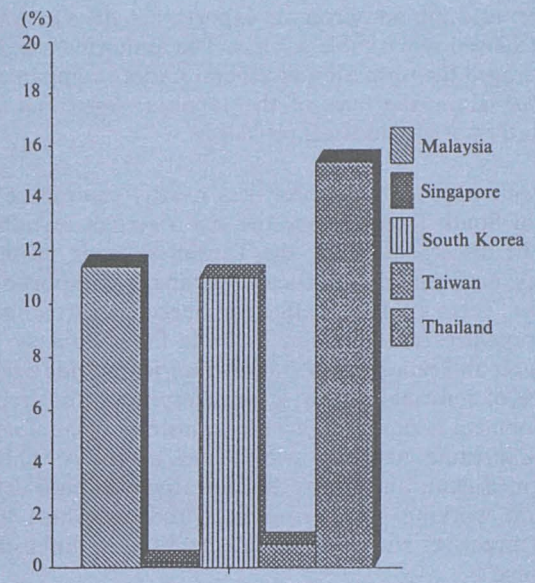
Population (1990): 56,4 million
GDP per capita: USD 1,160

Sectoral share of GDP (1990):

Agriculture:	14,2%
Industry:	35,3%
Services:	50,1%

Source: Asian Development Bank.

GRAPH 21: **DAEs — External debt**
Debt service as a proportion of exports (1990)



Source: Asian Development Bank.

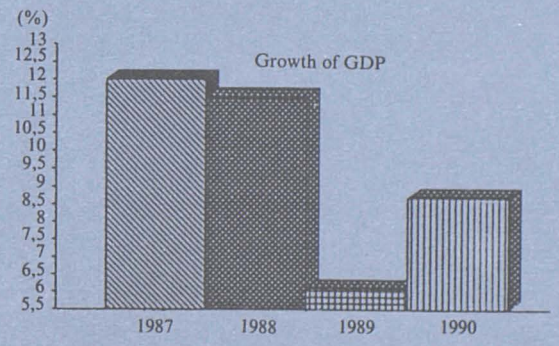
In Singapore, on the other hand, government presence in the market place has been rather less obtrusive. The Government of Singapore Investment Cooperation (GSCI) has been an important channel for technology transfer. The Economic Development Board has maintained a lower profile than its counterparts elsewhere in the region. That said, however, it has provided capital for enterprises in priority sectors, supported research and development and sponsored a wide range of training programmes. The Trade Development Board, like its counterparts elsewhere in South-East Asia, offers sophisticated product promotion services and maintains an up-to-date and relevant database. Malaysia's development strategy, set out in the 'new economic policy', whilst essentially similar in conception and design to those of the other DAEs, places rather more emphasis on the attainment of social goals, *inter alia* opportunity creation for the *bumiputra*.

The success of the DAEs in ensuring the technology transfer and direct foreign investment critical to the realization of their development programmes rests on clearly defined and structured sectoral strategies administered by highly trained and motivated professionals. Foreign investment in labour-intensive sectors has been discouraged and indeed, in certain instances, prohibited.

Export requirements have been set (and export restrictions outlawed). Access to the domestic market is conditional on export performance and on local sourcing. Criteria by which a value may be set on the transferred technology and a cost-benefit analysis undertaken have been established. Local sourcing, upgrading and research and development requirements exist. Discretion is exercised. Incentives and obligations are tailored to sectoral goals. Moreover, the incentives offered to a particular enterprise are usually related to the investor's commitment to those goals and may be varied if necessary in the light of subsequent experience.

Financial linkages vary both internally within these countries and externally amongst these countries reflecting differences in their approach to the financial markets and portfolio adjustment. Singapore and Hong Kong are closely integrated into the international financial system. Malaysia's domestic financial sector, comprising some 23 local and 16 foreign banks as well as a smaller number of non-bank financial intermediaries, has undergone a significant broadening and deepening over the past four years to the point at which it may shortly play a significant role as a channel for regional capital. Current reforms will reinforce this trend.

GRAPH 22: **South Korea — Basic data**



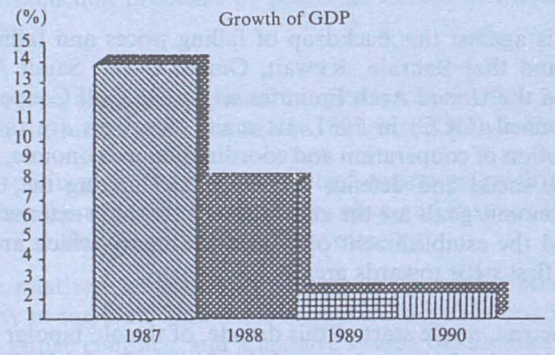
Population (1990): 42,8 million
GDP per capita: USD 4 400

Sectoral share of GDP:

	(%)
Agriculture:	8,3
Industry:	45,5
Services:	46,1

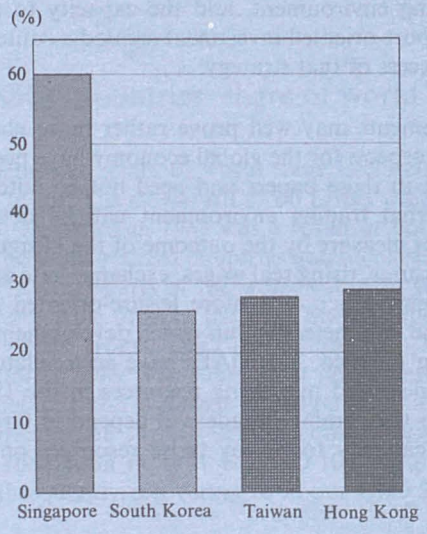
Source: Asian Development Bank.

GRAPH 23: **Hong Kong — Basic data**



Source: Asian Development Bank.

GRAPH 24: **Structure of exports**
High-tech exports (percentage of total 1987)



Source: OEDC.

Financial institutions in Taiwan and South Korea on the other hand, although becoming more market oriented, have long been segmented from the international financial system. Financial policy has been perceived primarily as an element of development policy and has been characterized by tight control over interest rates and credit allocation, with little discretion allowed to lending institutions. Outward capital flows, now significant in both countries, have tended to be directed through non-financial intermediaries.

These economies do not face the external financing constraints encountered by many developing countries. On the contrary the economic expansion of the region has been largely self-financing. Prudent policies, an inflow of investment capital and the basic resilience of their economies has kept external indebtedness low. The range of debt service obligations, running from 15,4% of export earnings in the case of Thailand to 0,9% in that of Taiwan contrasts favourably with Latin American countries such as Brazil, Argentina and Mexico in which debt service ratios were 31,3, 36,1 and 39,6 respectively in 1989.

The success of the outwardly oriented development strategies adopted by these countries is most clearly demonstrated by the increasing integration of their economies with those of the industrialized world. In 1982 56,8% of the DAEs' exports and 55,8% of those countries' imports were directed towards the industrialized nations.

Although the pace of growth slowed appreciably towards the end of the 1980s, due in part to higher factor costs and a less buoyant global trading environment, by 1990 the proportion of exports destined for the markets of the industrialized world had risen to 62,9% and that of imports to 60,6%.

Of the four DAEs[1] for which the data have been compiled the increase in technology-intensive exports as a proportion (in value) of total exports was most marked in the case of Singapore. Singapore raised the proportion of technology-intensive exports to total exports from 40% in 1980 to 60% in 1987. In Korea the increase was from 18% in 1980 to 26% in 1987 whilst in Taiwan the corresponding figures were 22 and 28% respectively. In Hong Kong the increase was from 24 to 29%.

The rapid development of the South-East Asian economies in the 1980s derived in the first instance from their capacity

[1] Singapore, South Korea, Taiwan and Hong Kong.

to formulate and effectively implement strategies which emphasized the role of the private sector in the development process and created an enterprise-friendly environment in which business could operate with minimal interference from third parties. A buoyant global economy, a favourable external trading environment, and the capacity to attract and retain export-oriented investment created a context essential to the success of that strategy.

These elements may well prove rather more elusive in the 1990s. Prospects for the global economy have been analysed elsewhere in these papers and need not be reiterated here. The external trading environment will be determined in significant measure by the outcome of the Uruguay Round. Cost pressures, rising real wages, exchange-rate appreciation and the emergence of a more leisure-oriented society has altered the parameters within which development objectives have been pursued. The DAEs have accumulated valuable technological and marketing resources in the 1980s. Their success in the coming decade will depend in large measure on their capacity to deploy those resources on their own account.

2. The countries of the Gulf Cooperation Council

With oil production as the economic driving force and partly in response to the massive increase in oil revenues following the first oil-price shock, the six countries of the Gulf Cooperation Council (GCC) began developing very quickly in 1973-74. In the 1980s, however, falling oil prices and changes in the industrialized countries' patterns of demand led to much slower growth and several years of recession, forcing the Gulf States to adopt strategies for industrial diversification.

2.1. Background

It is against this backdrop of falling prices and falling demand that Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates set up the Gulf Cooperation Council (GCC) in 1981. Its main objectives are the promotion of cooperation and coordination in economic, political, social and defence matters. Chief among the GCC's economic goals are the adoption of a common external tariff and the establishment of a customs union, which are seen as first steps towards greater integration.

The end, at the start of this decade, of the old bipolar world order, the fragmentation of the former Soviet Union and the new cooperation ties developing in the region, the repercussions of the Iraq-Kuwait conflict on relations between Arab States and the resumption of negotiations for a Middle-East peace process have all altered the political climate and the place of the GCC countries in the regional landscape. This new situation gives rise to a whole host of new risks and uncertainties.

Meanwhile, there is an increasingly urgent need for change and internal development on the part of the Gulf countries. The conflict with Iraq and the intervention of the coalition highlighted the need for reform, especially with regard to participation in the political system and the modernization of the economic structures, particularly the financial sector.

Table 32

GNP, living standards and population

	GNP (billion USD)	Per capita GNP 1989 (USD)	Population (million)	Population: annual percentage increase 1980-89
Saudi Arabia	86	6 020	14,4	5,0
Kuwait	32	16 380	2,0	4,4
UAE	28	18 430	1,5	4,6
Oman	8	5 220	1,5	4,7
Bahrain	3	6 360[1]	0,5	—
Qatar	7	n.a.	0,4	—
Total	164	8 060	20,3	4,9
OECD (token entry)	14 748	19 090	773	0,6

[1] 1988

Source: World Bank.

These factors make it imperative for the Gulf countries to strengthen their development strategies and should lead them to step up their cooperation and regional integration efforts. This is made all the more urgent by the recognition of a whole series of problems (other than those of security), such as environmental problems or problems related to the use of water.

Yet progress regarding regional integration since 1981 has been on the modest side, for reasons connected with both:

(i) the political systems in force, which maintains rivalries, keeps the recurrent border issues alive and sustains the fears arising from the group's asymmetry;

(ii) the relatively underdeveloped state of the market economy in the Gulf States. Most business depends heavily on public contracts and a massive system of subsidies.

2.2. Economic trends in the 1980s

Exceptional growth in the GCC countries from 1973/74 to 1979 was followed by a marked downturn which began in certain member countries in 1980 and spread to the others between 1982 and 1985, as the industrialized countries' demand for petroleum products fell and energy substitution and energy-saving policies took effect.

The latter half of the 1980s saw a return to positive growth, although well below the levels of the previous decade. Economic recovery in certain industrialized countries is undoubtedly the main reason for this upturn, although industrial diversification policies implemented by the Gulf States since the late 1970s have also played their part.

Table 33

Volume growth in GDP

(% p.a.)

	1980-81	1982-85	1986-89
Saudi Arabia	8,3	−7,6	3,7
Kuwait	−21,3	−1,0	6,5
UAE	14,6	−3,9	4,3
Oman	10,3	15,0	3,5
Bahrain	−5,2	0,1	3,7
Qatar	n.a.	n.a.	n.a.
Weighted average	4,4	−4,4	4,3

Sources: based on World Bank data.

Iraq's invasion of Kuwait in August 1990, and the outbreak of war the following February, paralysed economic life — and above all investment — in the region for several months. By January 1993, however, it was more or less business as usual (apart from Kuwait oil production).

2.3. The GCC countries' share of world trade

The GCC countries' share of world trade is closely related to the price of oil. The downturn in oil prices which began in 1980 and sharpened in 1982 was a result of both falling demand in the industrialized countries and increased supply as oil fields in other parts of the world came on stream. It led to an appreciable drop in the Gulf States' export earnings: they fell from USD 165 billion in 1981 to USD 69 billion in 1989. The subsequent fall in imports was somewhat delayed and different in magnitude and so the GCC countries' trade surplus shrank considerably, falling from USD 105 billion in 1981 to USD 10 billion in 1986, although subsequently recovering to about USD 20 billion in 1989.

Table 34

External trade

(billion USD)

	1980	1986	1987	1988	1989
Exports	156,2	47,2	55,1	58,1	69,2
Per cent oil	95	66	58	52	n.a.
Imports	52,0	37,5	38,2	46,7	48,4
Trade surplus	104,3	9,7	16,9	12,0	20,7
p.m. oil price[1]	35,7	13,0	16,9	13,2	15,7

[1] Arabian light — USD per barrel.

Sources: IMF, Unctad, *BP Statistical Review of World Energy*.

The GCC countries' share of total world exports dropped from 8,2% in 1980 to 2,4% in 1989, while their share of world imports fell in the same period from 2,7 to 1,6%.

Oil remains the Gulf's key export. Falling prices and some export diversification, however, led oil's share in the Gulf's total exports to fall from 95% in 1980 to a little over 50% by the end of the decade.

Table 35

Oil output, refining capacity and oil reserves

	Oil output (1 000 barrels per day) 1990	Refining capacity (1 000 barrels per day) 1990	Billion barrels	Oil reserves reserves/production	
				% share world total	years
Saudi Arabia	6 700	1 860	257,5	25,5	100
Kuwait	1 065	820	94,5	9,4	100
UAE	1 850		92,2	9,1	100
Abu Dhabi, Dubai and Northern Emirates	450		5,9	0,6	36,6
Oman	660		4,3	0,4	18,0
Bahrain		250			
Qatar	455		4,5	0,4	27,8
GCC	11 180	2 930	458,9	45,5	
World (token entry)	64 875	75 775	1 009,2	100,0	43,4
OPEC	24 775				

Source: BP, *Statistical Review of Energy.*

2.4. Oil reserves

Saudi Arabia, Kuwait, the United Arab Emirates, Oman, Bahrain and Qatar together control 45% of the world's known oil reserves. Qatar and Saudi Arabia also possess major gas reserves. The GCC countries currently account for between 15 and 20% of world oil production. The ratio of reserves to output is considerably greater than in most producer countries. In its medium-term forecasts, the World Bank foresees the world coming to depend increasingly on a handful of countries for its oil supplies, namely Saudi Arabia, Iraq, Iran, Kuwait and the UAE. Such a concentration of supply depends of course on the discovery of new oilfields and the policies of other producers, particularly the former Soviet Union.

2.5. Geographical breakdown of GCC countries' trade

The GCC countries' leading export partners in 1989 were Japan (25%), followed by the Community (16%) and the United States of America (13%).

In the 1980s the Community not only cut the total volume of its oil imports, it also appreciably reduced its dependence on GCC producers: whereas in 1980 they had supplied 37% of Community oil imports, they now supply only 14%. This explains the marked drop in the share of GCC exports going to the Community. Thus falling oil exports were only partly offset by diversification to other products.

The Community is far and away the leading supplier of GCC imports (36% of all imports in 1989), followed by the USA (13%) and Japan (13%). Intra-regional trade remains insignificant.

Throughout the 1980s the Community held its market share at about 35% in the face of increasing pressure from certain developing countries. The GCC countries account for a far from negligible 3,2% of Community exports.

Besides the capital goods making up most of the industrialized countries' exports to the Gulf, agricultural products account for a relatively large share of Community exports to the region: 12,9% in 1990, which is considerably more than the share of agricultural products in the Community's total exports to non-member countries (8,5%).

Seeking to go beyond their traditional cooperation, the Community and the GCC countries are currently considering negotiating a free trade agreement, which would gradually reduce tariff barriers between the two regions. This would enable the Gulf countries to expand their petrochemical capacity and in turn enable Community exporters to increase their market share in the Gulf countries: markets which show considerable potential for growth.

Table 36

Geographical breakdown of the GCC's exports and imports

(%)

	Exports		Imports	
	1980	1989	1980	1989
Industrialized countries	71,2	56,6	73,8	67,6
Community	34,5	15,6	34,7	36,1
USA	11,7	13,2	16,7	13,0
Japan	21,2	24,7	17,6	12,5
Developing countries	25,0	35,1	22,1	29,0
Within GCC	3,0	5,2	6,6	7,1
Total	100,0	100,0	100,0	100,0

Sources: IMF, *Direction of Trade Statistics.*

2.6. Diversification of economic activities

In the late 1980s oil and gas continued to account for about 30% of the six Gulf States' total GDP. Most government revenue came from oil.

Oil's economic importance has, however, been in decline since the early 1980s. This is attributable not only to falling prices, but to a policy of economic diversification.

The uncertain behaviour of oil prices over the long term, their often short-term instability and, perhaps more important, the finite nature of petrocarbons as a resource, have led the Gulf States to prepare an industrial diversification strategy.

Short of labour (immigrant workers make up over half the working population), the GCC countries have naturally chosen a development strategy based on capital-intensive activities and sectors in which they enjoy a clear comparative advantage.

Table 37

Composition of exports to the GCC countries in 1990

(%)

	EC	EFTA	USA	Japan
Agricultural products	12,6	6,4	16,7	0,4
Manufactures	76,8	90,6	71,9	98,5
Chemicals	11,1	10,2	5,2	1,4
Semi-finished goods	4,4	11,2	2,5	4,9
Engineering products	42,0	38,9	53,5	70,2
Textiles and clothing	4,0	3,5	3,4	8,0
Other consumer goods	12,5	26,0	6,8	8,0
Total	100,0	100,0	100,0	100,0

Source: Comtrade.

Table 38

Economic importance of oil and gas

	% of GDP (1989)	% of government revenue	% of exports (1988)
Saudi Arabia	27	66	83
Kuwait	41	80	88
UAE	36	83	70
Oman	41	79	91
Bahrain	14	55	78
Qatar	29	n.a.	n.a.
Weighted average	31		

Sources: World Bank, *World Tables*, 1991; *The Economist* Intelligence Unit; OECD, IEA, *Energy Statistics and Balances.*

There has been substantial investment in the petrochemical, aluminium, steel and cement industries. Traditional manufacturing sectors have also seen some development. Notwithstanding that, construction remains (if oil is disregarded) a major economic driving force.

Table 39

GDP by sector (1989)

(% of total)

	Agriculture	Oil/gas	Manufacturing	Construction	Services	Other
Saudi Arabia	7	27	8	10	44	3
Kuwait	1	41	14	2	42	0
UAE	2	36	9	9	38	5
Oman	4	41	4	4	45	2
Bahrain	1	14	16	6	61	2
Qatar	1	29	13	5	50	1

Source: *The Economist* Intelligence Unit.

As already noted in the 1980s, being a period of more moderate increases in oil revenue, growth led by the public sector (the State being at one and the same time responsible for redistributing oil earnings and the chief investor) was

down appreciably on the 1970s. However, supported by incentives (subsidies, tax exemptions, provision of pre-equipped industrial estates), the private sector is now developing.

The impact of the diversification of the Gulf countries both as regards trade with the world as a whole and with the Community is set out in Table 40.

Table 40

Product composition of imports from the Gulf countries: 1980 and 1990

(%)

	EC		EFTA		USA		Japan	
	1980	1990	1980	1990	1980	1990	1980	1990
Oil	97,1	85,8	95,3	44,7	99,5	96,2	99,8	97,2
Manufacturing products	1,6	11,7	1,1	34,0	0,0	2,6	0,0	1,2
of which:								
Chemical products	0,0	2,9	0,0	8,4	0,0	0,9	0,0	1,2
Engineering goods	1,3	5,6	0,0	2,8	0,0	0,1	0,0	0,0
Others	0,2	1,7	0,8	16,9	0,0	0,0	0,0	0,0

Source: Comtrade.

2.7. Development aid, investment and capital inflows

Current-account surpluses have led to the accumulation of considerable foreign holdings of various assets by the Gulf countries. Most of the Gulf's foreign investment has been in the industrialized world.

The external holdings and the finances of the Gulf States have, however, fluctuated considerably owing to unstable oil prices (up in 1973/74 and 1979, starting downward in 1981 and falling considerably in 1986), the instability of the US dollar, the world business situation and interest rates.

Until the early 1980s the trade surplus and the income from holdings abroad greatly exceeded the deficit recorded on services (particularly freight and insurance) and the considerable private transfers (immigrant workers sending home their wages).

Part of the surplus was allocated as development aid. The GCC countries provide a great amount of official develop-

Table 41

Official development assistance

(1989 prices and exchange rates)

	Billion USD		% world ODA		% GNP	
	1980-81	1989-90	1980-81	1989-90	1980-81	1989-90
Saudi Arabia	8,0	2,2	14,5	4,0	4,0	6,1
Kuwait	1,6	0,8	3,0	1,5	3,6	5,9
UAE	1,4	0,4	2,5	0,7	3,3	3,5
GCC Total	11,0	3,4	19,9	6,2	—	—
OECD DAC	37,4	47,6	67,5	86,5	0,36	0,35
World total	55,4	55,2	100	100		

Source: OECD DAC.

ment assistance (ODA). In 1980-81 they provided 20% of world ODA. In 1989-90 that percentage had fallen to a little over 6%. The Gulf States still, however, allocate between 3 and 6% of GDP in ODA, compared with a world average of 0,35%.

During the 1980s the Gulf States' external asset holdings declined and they began to experience budget deficits (Saudi Arabia recorded its first in 1983-84). These deficits were covered by the repatriation of public capital. More recently, the exceptional costs of the Gulf crisis in 1990-91 (aid to the countries hit hardest by the embargo and the crisis, and transfers to help finance the coalition's military operations) caused the Saudi and Kuwaiti authorities, in 1991, to seek long-term loans abroad (USD 4,5 billion and USD 5,5 billion respectively).

Against this backcloth, and in view of the investment required for domestic industrial development, foreign investment and in particular foreign direct investment, to which the Gulf States have always taken a relatively liberal attitude, is playing, and is likely to continue to play, an increasingly important role.

In the past there has been little European investment in the GCC countries. Outside the oil sector, it has been concentrated mainly in financial services.

3. The developing countries of the Mediterranean

If the Community's Mediterranean Member States are disregarded, the Mediterranean — the very birthplace of international trade — today accounts for only a modest share of world trade. The main statistical sources do not even consider the region a market in its own right, often splitting its countries between Africa, Western Europe or the Middle East.[1]

The 1980s saw the first signs of a divide between those Mediterranean States recording significant growth, others experiencing slower growth and, lastly, those beset by mounting problems.

[1] Neither the IMF's trade statistics nor those of the GATT or Unctad group the Mediterranean countries in a single area. Any study of the region therefore requires a reconstitution based on data from individual countries, which is often published with considerable delays.

3.1. Modest and uneven trade performances

Taken together the Maghreb (Algeria, Morocco, Tunisia and Libya),[2] the Mashreq (Egypt, Syria, Lebanon and Jordan), the Northern Mediterranean countries (Yugoslavia, Turkey, Malta and Cyprus) and Israel, the region's exports in 1990 totalled USD 81,7 million or 2,46% of the world total. Imports totalled USD 110,1 million or 3,19% of world imports (see Table 42).

In 1980 the region's exports represented 3,55% of world exports and 3,84% of world imports. Thus the Mediterranean's share of world trade declined in the 1980s, even if in a somewhat irregular way. The loss of market share is also apparent when compared with that of the developing countries as a group. Whereas the Mediterranean countries accounted for 10,5% of developing countries' exports in 1980, that share had dropped to 9,4% by 1990 (see Table 43).

However, this general downturn conceals figures that differ appreciably from country to country.

The Maghreb has been hit hardest, seeing its share of world exports fall from 2,22 to 0,92% and that of imports from 1,28 to 0,83%. This is directly attributable to deteriorating terms of trade caused by a substantial drop in oil and gas prices[3] and the long-term erosion of commodity prices.[4]

Libya and Algeria have suffered most. In the period 1980-90 Libya's exports fell from USD 21,9 million to USD 10,4 million and those of Algeria from USD 15,6 million to USD 12,3 million. Tunisia's exports also sagged around the mid-1980s. Morocco too was affected, particularly in the first half of the decade, by an appreciable drop in phosphate prices.

The Mashreq's overall trade figures have been less disappointing than the Maghreb's. Its trade was none the less also damaged by the same adverse commodity price movements, to which must be added the conflict in Lebanon.

[2] This is the Greater Maghreb. The very broad definition of the Greater Maghreb used in the Treaty of Marrakesh, which set up the Maghreb Arab Union, included Mauritania. The latter is excluded in this paper because it does not border the Mediterranean.

[3] In the case of Algeria, the terms of trade went from 195,8 in 1980 to 73,4 in 1988. In the absence of any formal reference in the Unctad statistics, these figures may be extended to Libya.

[4] Tunisia's terms of trade declined from 141,2 in 1980 to 94 in 1988, while those of Morocco fell in the same period from 108,8 to 103,9, after touching 88,8 in 1985.

Table 42

Trade statistics of the Mediterranean countries

(billion USD)

	Exports			Imports		
	1980	1985	1990	1980	1985	1990
Algeria	15,6	12,8	12,3	10,6	9,8	10,5
Libya	21,9	10,9	10,4	6,8	5,4	5,9
Morocco	2,4	2,2	4,3	4,2	3,9	6,9
Tunisia	2,2	1,8	3,5	3,5	2,8	5,5
Maghreb	42,2	27,7	30,5	25,1	21,9	28,8
Egypt	3,0	1,8	4,9	4,9	5,5	12,8
Syria	2,1	1,6	4,4	4,1	4,0	2,5
Lebanon	1,0	0,4	0,5	3,8	2,0	2,4
Jordan	0,5	0,8	0,9	2,4	2,7	2,8
Mashreq	6,7	4,6	10,7	15,2	14,2	20,5
Turkey	2,9	8,0	12,4	7,7	11,3	20,8
Yugoslavia	8,9	10,7	14,3	15,1	12,2	18,9
Cyprus	0,5	0,5	1,0	1,2	1,3	2,6
Malta	0,5	0,4	1,1	0,9	0,8	2,0
North Mediterranean	12,9	19,5	28,8	24,9	25,6	44,3
Israel	5,5	6,3	11,7	9,6	10,0	16,5
Total	67,3	58,1	81,7	74,8	71,7	110,1
Developing countries	636,3	547,6	867,1	557,8	519,5	881,9
EC (incl. intra-EC trade)	691,2	647,5	1 370,9	772,5	660,8	1 416,2
World	1 895,5	1 820,1	3 325,0	1 946,4	1 885,7	3 455,0

Source: IMF *Direction of Trade Statistics.*

Although not major energy suppliers (22nd and 23rd in the world in 1987/88), Syria and Egypt were also affected by the fall in demand for oil following the second oil-price shock and the subsequent developments. The Mashreq saw its share of world exports fall from 0,35 to 0,32%, while that of imports went from 0,77 to 0,59%.

In contrast, the countries to the north and north-east of the Mediterranean have seen their share of world trade increase. They benefited from the very factors which brought a considerable deterioration in the Mashreq and Maghreb countries' terms of trade.[1] This benign trend contributed, in the 1980s, to an increase of almost 50% in Malta's share of world trade and, more important still, to that of Turkey. Thus, while Yugoslavia and Cyprus more or less held their shares of the world export market, Turkey more than doubled its share between 1980 and 1990 (from 0,15% of world exports in 1980 to 0,37% in 1990), overtaking Israel (0,35% of world exports in 1990) and — in 1990 — practically equalling Yugoslavia (0,43% of world exports), which had long been the region's main non-Community economic and trading power. Disregarding the Community, and noting the developments in what was once Yugoslavia, Turkey is now the Mediterranean's leading trade power.

An analysis of trade in services would, in the main, produce similar conclusions to these set out above. Thus, during the latter part of the 1980s and apart from Yugoslavia, whose

[1] Turkey, Cyprus and Yugoslavia saw their terms of trade improve by up to 15 points in the period 1980-88.

Table 43

Trade statistics of the Mediterranean countries

(% of world trade)

	Exports			Imports		
	1980	1985	1990	1980	1985	1990
Algeria	0,82	0,71	0,37	0,54	0,52	0,30
Libya	1,15	0,60	0,31	0,34	0,28	0,17
Morocco	0,12	0,11	0,13	0,21	0,20	0,20
Tunisia	0,11	0,10	0,11	0,18	0,15	0,16
Maghreb	2,22	1,52	0,92	1,28	1,16	0,83
Egypt	0,16	0,10	0,15	0,24	0,29	0,37
Syria	0,11	0,09	0,13	0,21	0,21	0,07
Lebanon	0,05	0,02	0,02	0,20	0,10	0,07
Jordan	0,02	0,03	0,03	0,12	0,14	0,08
Mashreq	0,35	0,25	0,32	0,77	0,75	0,59
Turkey	0,15	0,44	0,37	0,39	0,59	0,60
Yugoslavia	0,47	0,59	0,43	0,77	0,64	0,55
Cyprus	0,02	0,02	0,03	0,06	0,06	0,08
Malta	0,02	0,02	0,03	0,04	0,04	0,06
North Mediterranean	0,68	1,07	0,87	1,27	1,36	1,28
Israel	0,29	0,34	0,35	0,49	0,53	0,48
Total	3,55	3,19	2,46	3,84	3,80	3,19
Developing countries	33,57	30,09	26,08	28,65	27,55	25,53
EC	36,47	35,57	41,23	39,69	35,04	40,99

Source: IMF *Direction of Trade Statistics.*

balance of trade in services deteriorated considerably, the Northern Mediterranean countries (i.e. Turkey, Malta and Cyprus) registered substantial growth in services, achieving a surplus in this sector of the economy (see Table 44).

The same is true of Tunisia and Morocco, which were also the Maghreb countries which recorded the best trade results.

3.2. Substantial differences in the rates of economic changes and transformation observed

There is a clear correlation between the trade figures of the Mediterranean countries, their overall economic performance and the gradual realignment of their exports in the course of the 1980s. Those which achieved the best economic results, that is improved the people's standard of living without unbalancing the economy, are those which thor-

Table 44

Trade in services[1]

Aggregate figures (billion USD)

	1985		1991	
	Earnings	Expenditure	Earnings	Expenditure
Turkey	2,6	1,3	7,5	2,8
Malta	0,3	0,2	—	—
Israel	3,1	2,7	4,6	5,7
Cyprus	0,8	0,3	—	—
Jordan	1,2	1,3	—	—
Yugoslavia	3,2	3,4	2,5	5,6
Morocco	1,0	0,8	1,8	1,3
Tunisia	1,1	0,6	1,4	0,8

[1] Data for Algeria, Lebanon, Libya and Syria not available; Egyptian figures in non-standard format and consequently excluded.

Source: IMF *International Financial Statistics.*

oughly transformed their structures of production and diversified exports. Trends in the relative shares of a country's exports accounted for by agricultural products, raw materials and manufactures provide a measure of the economic transformations that have been made.

From this point of view, the Mediterranean countries may be divided into three broad groups (see Tables 45 to 48).

The first comprises Algeria, Libya, Syria and Jordan, where economic structures have undergone little change.

The Algerian and Libyan economies have continued to depend heavily on the exploitation of their raw energy resources. The percentage share of manufactures in Algeria's industrial output grew very modestly from 9% in 1980 to 11% in 1989. The same is probably true of Libya, even if

Table 45

Structure of exports

(%)

	1980			1988		
	Agriculture	Energy and minerals	Manufactures	Agriculture	Energy and minerals	Manufactures
Turkey	6,5	8	27	26	8	66
Malta	5	1	94	5	3	92
Israel	16	2	82	10	3	87
Cyprus	35	10	55	38	3	59
Jordan	25	41	34	10	45	45
Algeria	1	99	0	1	96	3
Egypt	22	67	11	20	41	39
Lebanon	27	8	64	28	4	66
Libya	0	100	0	0	98	2
Syria	16	78	6	27	42	30
Yugoslavia	18	9	73	12	8	80
Morocco	31	45	24	30	23	47
Tunisia	8	56	36	11	23	66

Source: Unctad *Handbook of International Trade Statistics, 1990.*

Table 46

Debt of the Mediterranean countries

(%)

	Total debt (USD billion)			Ratio of debt service to exports			Ratio of total debt to GNP		
	1980	1985	1990	1980	1985	1990	1980	1985	1990
Turkey	19,1	26,0	49,1	28	35	28	34	51	46
Malta	0,1	0,2	0,6	1	2	2	9	17	25
Cyprus	0,5	1,3	3,0	8	15	11	25	56	56
Jordan	1,9	4,1	7,6	8	18	25	—	87	226
Algeria	19,3	18,3	26,8	27	36	59	47	32	53
Egypt	21,0	41,8	39,8	15	28	26	98	133	127
Lebanon	0,5	1,0	1,9	—	—	—	—	—	—
Syria	3,5	10,8	16,4	11	13	26	27	66	118
Yugoslavia	18,5	22,2	20,7	21	19	14	26	48	24
Morocco	9,7	16,5	23,5	33	33	23	53	137	97
Tunisia	3,5	4,9	7,5	15	25	26	42	62	62

Source: World Debt Tables 1991-92.

Table 47

Net inflow of foreign investment

(million USD)

	1981-85	1986-90
Turkey	408	1 954
Malta	130	134
Israel	−82	479[1]
Cyprus	329	360
Jordan	272	86
Algeria	−96	34
Egypt	5 251	5 917
Libya	−1 405	−348[2]
Syria	0	0
Yugoslavia	0	0
Morocco	251	478
Tunisia	1 026	352

[1] to 1989.
[2] to 1988.
Source: World Debt Tables 1991-92.

Table 48

Trends in the terms of trade

(Index: 1987 = 100)

	1980	1985	1988
Turkey	92,2	86,4	107,1
Malta	104,2	88,9	100,4
Israel	103,6	103,7	100,9
Cyprus	97,7	95,0	101,7
Jordan	108,2	94,3	106,9
Algeria	195,8	182,8	73,4
Egypt	161,6	135,3	97,0
Syria	153,4	131,4	77,7
Yugoslavia	88,3	94,8	107,1
Morocco	108,8	88,8	103,9
Tunisia	141,2	114,9	94,0

Source: World Bank *World Tables 1991.*

precise statistics are unavailable. With agriculture remaining a very marginal economic sector in these countries, their exports consist almost entirely of unrefined or basic energy products (Libya was the world's sixth exporter of crude oil in 1987/88, Algeria was tenth). Unable to find any means of offsetting falling oil earnings, their worsening financial situation[1] has been aggravated by the deliberate discouragement of foreign investment or by considerable disinvestment by overseas investors.[2] Algeria's real per capita GDP rose by a mere 0,2% on average annually between 1980 and 1989.[3]

The above is also largely true for Syria[4] and Jordan.

Syria, an exporter of energy products but also of cotton (of which it was the world's seventh producer in 1987/88), is cut off from foreign investment.[5] Heavily in debt (its total external debt went from 27% of GNP in 1980 to 118% in 1990), Syria has done practically nothing to diversify exports (the concentration index went from 0,619 to 0,518 in the period 1980-88);[6] its real per capita GNP fell by 1,6% in the course of the decade.[7]

Table 49

Trends in per capita GNP

(current USD)

	1980	1985	1989
Turkey	1 390	1 080	1 370
Malta	3 150	3 390	5 820
Israel	5 390	6 570	9 750
Cyprus	4 117	5 026	7 050
Jordan	1 636[1]	1 880	1 730
Algeria	1 940	2 580	2 220
Egypt	500	660	630
Libya	9 740	6 560	5 410[2]
Syria	1 410	1 720	1 100[2]
Yugoslavia	3 250	2 040	2 920
Morocco	930	610	880
Tunisia	1 280	1 170	1 260

[1] 1983.
[2] 1988.
Source: World Bank *World Tables 1991.*

[1] Algeria's debt increased from USD 19,3 billion in 1980 to USD 26,8 billion in 1990. Figures for Libya are not available.

[2] In the course of the decade Algeria lost USD 62 million in foreign investment and Libya USD 1,753 billion.

[3] Unctad *Handbook of International Development Statistics*, 1990, p. 437.

[4] A lack of statistics prevents accurate assessment of trends in the structure of Syria's production.

[5] The World Bank recorded no foreign investment in the 1980s.

[6] The export concentration index used is that of Unctad. The index ranges from 0 to the maximum of 1.

[7] Unctad *Handbook of International Development Statistics*, 1990, p. 439.

Although Jordan's economic system is not shaped by ideology like the countries considered above, the country has none the less experienced major economic difficulties.[1] The structure of production changed very little during the 1980s (agriculture accounting for about 7% of GNP and manufactures for another 13%) and its export concentration index rose appreciably from 0,352 in 1980 to 0,439 in 1988. External debt has grown substantially (from 87% of GNP in 1985 to 226% in 1990) and the inflow of foreign investment has been tailing off for some time (inflows amounted to USD 272 million for the period 1980-90, whereas the period 1985-90 accounted for only USD 86 million). Moreover, real per capita GNP rose by a mere 0,3% on average annually between 1980 and 1989.[2]

The second group is made up of countries which, unlike those above, have — sometimes radically — restructured their economies. Turkey and Tunisia belong to this group as do, in some aspects at least, Egypt and Morocco.

Turkey has undertaken major industrialization; manufacturing increased its share of GNP from 20,9% in 1980 to 25,5% by 1989, while the share of agriculture fell in the same period from 20,7 to 16,4%. This industrialization, assisted by vigorous growth in the inflow of foreign investment (USD 2,3 billion in the period 1981-90) and bringing no excessive increase in the external debt,[3] has had a more than equivalent impact on export structure. The share of agricultural products fell from 65 to 23% while that of manufactures increased from 27 to 66%. The country's export concentration index decreased considerably from 1980 to 1989 (0,230 in 1980, 0,101 in 1988). It is now more or less comparable to that of the leading industrialized nations. Real per capita GNP increased by 3% on average annually in the period 1980-89.[4]

Tunisia has developed in a relatively similar fashion, characterized by a reduction in agriculture's share of GNP (from 17% in 1980 to 13,6% in 1989), an increase in that of manufacturing industry (from 12,8% in 1980 to 16,4% in 1989) and an appreciable restructuring of exports: manufactures increased their share of Tunisia's exports from 36 to 66% in the course of the decade. Its debt has, however, also increased considerably, even if the country has so far been

[1] The dearth of statistics notwithstanding, Lebanon seems to be in a similar situation to Jordan. Its present economic decline would, however, seem to be more pronounced, given the seriousness and duration of its travails throughout the 1980s.

[2] Unctad *Handbook of International Development Statistics, 1990*, p. 439.

[3] The total external debt for 34% of GNP in 1980 and 46% in 1990.

[4] Unctad *Handbook of International Development Statistics, 1990*, p. 439.

Table 50

Geographical breakdown of Mediterranean countries' exports in 1980

(%)

	EC	EFTA	USA and Canada	Japan	Mediterranean	Other developing countries[1]	Eastern Europe
Turkey	43	10	5	1	11	13	17
Malta	78	5	2	0	8	2	4
Israel	40	11	18	4	2	21	1
Cyprus	31	2	1	0	27	32	6
Jordan	2	2	0	3	16	68	8
Algeria	40	5	48	3	1	1	2
Egypt	46	9	8	2	9	9	11
Lebanon	7	4	4	0	14	64	7
Libya	39	9	36	1	5	7	3
Syria	63	1	4	0	6	10	18
Yugoslavia	26	5	5	0	6	12	45
Morocco	56	11	2	2	4	14	11
Tunisia	72	1	15	0	5	6	1

[1] Total trade with developing countries is calculated by subtracting trade with the developed countries, the countries of Central Europe and the Mediterranean.

Source: Unctad *Handbook of International Trade Statistics*, 1990.

Table 51

Geographical breakdown of Mediterranean countries' exports in 1988-89

(%)

	EC	EFTA	USA and Canada	Japan	Mediterranean	Other developing countries[1]	Eastern Europe
Turkey	47	3	9	2	8	21	8
Malta	76	1	6	0	6	8	2
Israel	32	4	32	7	1	21	1
Cyprus	55	3	2	1	18	14	7
Jordan	8	0	0	2	8	77	4
Algeria	58	2	20	3	2	13	2
Egypt	43	2	5	4	14	8	17
Lebanon	0	0	0	0	0	0	0
Libya	78	6	0	0	5	6	5
Syria	34	1	2	0	5	15	41
Yugoslavia	37	7	5	0	5	10	35
Morocco	65	2	3	5	8	13	4
Tunisia	74	0	2	0	8	14	2

[1] Total trade with developing countries is calculated by subtracting trade with the developed countries, the countries of Central Europe and the Mediterranean.
Source: Unctad *Handbook of International Trade Statistics*, 1990.

able to honour its commitments. The inflow of foreign investment (USD 1,378 billion in the period 1981-90) slowed in the latter half of the decade. However, only two countries in the region attracted more foreign investment than Tunisia. Real per capita GNP increased by 0,8% per annum in the course of the decade.[1]

Egypt and Morocco do not possess all the economic and financial features observed in Tunisia and still more apparent in Turkey. They are, however, diversifying their exports considerably (in 1988 manufactures accounted for 47% of Morocco's exports and 39% of Egypt's against 24 and 11% in 1980). A series of agreements with public and private creditors alike has enabled them to control and reduce their external debt, even if it remains considerable.[2] Last but not least, foreign investment is climbing. Morocco gained USD 729 million in the period 1981-90, notching up USD 478 million in the second half of the decade, while Egypt attracted USD 11,168 billion, including USD 5,917 billion from 1986 to 1990. The decade saw Morocco's per capita GNP decrease at an average annual rate of 0,3% in real terms and Egypt's increase at an average annual rate of 2,5%.[3] Egypt remains, however, the Mediterranean country with the lowest per capita GNP. It stood at USD 630 in 1989.

The third group brings together the remaining Mediterranean countries: Cyprus, Israel, Malta and Yugoslavia.

Malta, Israel and Cyprus in particular differ from the other countries of the region in their markedly higher per capita GNP (upwards of USD 5 000).

Their export structure is made up primarily of industrial products (manufactures account for over 80% of these countries' exports, except for Cyprus, where they represent 59%). They are among the least heavily indebted countries of the region, even if Yugoslavia had to restructure its external debt several times in the 1980s.[4] Although the World Bank recorded no foreign investment in Yugoslavia during that decade, Malta and Cyprus attracted USD 264 million and USD 689 million respectively. Notwithstanding the difference of scale between the two economies, Cyprus in the 1980s attracted foreign investment comparable in absolute terms to Morocco.

[1] Unctad *Handbook of International Development Statistics*, 1990, p. 437.
[2] Egypt's debt amounted to USD 39,8 billion in 1990, 127% of GNP, while Morocco's stood at USD 23,5 million or 97% of GNP.
[3] Unctad *Handbook of International Development Statistics*, 1990, p. 437.
[4] In 1990 Cyprus's debt service to GNP ratio stood at 56%, Malta's at 25% and Yugoslavia's at 24%.

3.3. The European Community: an important trading partner

Libya has been the only Mediterranean country not to benefit from the preferential trade arrangements that the Community has been establishing for over 15 years (including where applicable the GSP) with a view to providing easier access to its market for products originating in these countries.

That the Community is proving an increasingly attractive trading partner for many Mediterranean countries is demonstrated by Unctad and IMF statistics on world trade (see Tables 50 and 51).[1]

Apart from Libya and Algeria, which export only petroleum products, the markets for which differ significantly from those for other exports, five Mediterranean trading partners in the last decade increased the proportion of their exports destined for the Community: Cyprus, Yugoslavia, Morocco, Turkey and Tunisia.

The Community is not only their leading trading partner, it absorbs more than half their exports: 76% of Malta's, 74% of Tunisia's, 65% of Morocco's and 55% of Cyprus's. Turkey is on the verge of joining this group, since 47% of its exports are destined for the Community.

In contrast, the Community's influence is less dominant and would indeed seem to be declining in Israel (40% of 1980's exports was destined for the Community against 32% in 1989), Egypt (46% in 1980, 43% in 1989) and Syria (63% in 1980, 34% in 1988). Although growing, Jordan's share of Community imports remains insignificant (4% of Jordan's total exports in 1980 and 8% in 1989).

Reference to the latest Community statistics on trade with the Mediterranean countries would suggest that the trends in the development of trade flows discerned above are continuing into the 1990s. In line with past trends, the Community's trade (both exports and imports) with Cyprus, Malta, Turkey, Tunisia and Morocco continued to increase substantially in 1991. The trend is, however, either less pronounced or markedly unfavourable in Egypt, Jordan, Syria, Israel, Yugoslavia, Algeria and Libya.

[1] The percentages referred to below are based on Unctad statistics.

3.4. To sum up

The Mediterranean is currently doubly divided:

(a) One division results from the fact that one group of Mediterranean countries is moving increasingly into the Community's trade orbit. The countries concerned are north of the Rabat-Tunis-Ankara line. Conversely, those below that line seem less subject to Community influence.

(b) A second division, identical in many ways to the one above, is that between Mediterranean countries with satisfactory or clearly improving economic situations. Apart from Yugoslavia, which has now ceased to exist, all countries above the line plus Egypt belong to that part of the Mediterranean which is on the way to recovery and/or growth. The position of the other Mediterranean countries, to which Albania will have to be added, is less encouraging.

This leaves the borderline case of Algeria, whose economic and trade policy choices will determine to which of the two Mediterranean groups it belongs.

4. Concluding remarks

The introductory analysis of this section pointed to the marked variations in performance during the 1980s as between developing regions.

The subsequent examination of the pattern of events in these developing zones at greater length suggests a number of points or conclusions that might explain the different performances observed.

Firstly, however, a more general point should be considered. Two of the developing zones considered in this chapter reflect administrative rather than economic, political or even geographical considerations. The term 'administrative' means that they follow the grouping adopted for various reasons by the international and national institutions and aid agencies.

Thus, the grouping 'the dynamic Asian economies' refers to a group of South-East Asian economies of diverse political states, size, and economic structure, somewhat separated geographically but which exhibit certain similarities of economic performance. They do not form, however, a particularly well-integrated economic or political grouping and each country has enjoyed a somewhat different development experience.

As regards the developing countries of the Mediterranean basin the unifying features of this grouping are firstly the proximity of these countries both to the Community and to each other and secondly, for the majority of them, a certain cultural and ethnic affinity. Although certain regional political groupings have been established — Maghreb, Mashreq — these groupings have so far exhibited very limited economic and political integration.

In contrast the countries of the Gulf are taking deliberate steps along the path of economic and political integration and there have been solid achievements in this regard.

Such considerations suggest that a substantial diversity of economic experience within the developing zones examined may make it difficult to draw more general conclusions. None the less, despite this disadvantage the following general points can be made:

(i) As regards the dynamic Asian economies the rapid development they have enjoyed must reflect in part their capacity to generate substantial internal resources for investment. At the same time a strong export performance, partly due to the orientation of output and export structures towards the fast-growing high-tech parts of trade in manufactures, has encouraged a healthy inflow of external resources to finance investment — foreign direct investment. In this way investment as a proportion of GDP has remained high and growth rates have been maintained at exceptional levels — often into double figures.

(ii) As regards the Gulf countries it is now possible to discern, in the available data, the benefits of the policy of industrial diversification introduced at the beginning of the last decade. Thus, policy designed to reduce the dependence of the Gulf countries on one product — oil — has led first and foremost to the development of an important petrochemical capacity. In addition it has begun to move the Gulf economies away from a structure based on massive oil earnings, plus their redistribution via the State and their use by the State to finance public sector investment, to one where the private sector is beginning to expand both in manufacturing and in services.

(iii) The developing countries of the Mediterranean basin present a very mixed picture — those that have managed to adapt their economies to the realities of the world market — Turkey, Tunisia — have done well: those countries dependent upon a limited range of primary products, and which have been unable to adapt and diversify their industries, have seen their relative economic performance become less and less satisfactory.

Overall the experience of these three groups of developing countries points to the importance for the development process of internal reform and change. The external environment can only do so much. Developing countries must continue to search within themselves for the wellsprings of their own development.

Part Two

Expert contributions on new issues in international trade

This section contains three contributions by independent experts on new issues in international trade which flow from greater global economic interdependence. Opinions expressed in these contributions are those of the authors alone, and do not in any way reflect the views of the Commission or its services.

I — Trade and foreign direct investment[1]

D. Greenaway
Nottingham University, Nottingham, United Kingdom

Summary

The post-war period has seen dramatic growth both in international trade and foreign direct investment (FDI). Over the last decade the growth in investment has been especially marked.

The European Community is both the major source of FDI worldwide, and the major host to inward investment. The United States of America is also important, both as a host and as a source, whilst Japan is important as a source but not as a host.

EC inward investment is dominated by EFTA, the USA and Japan; it is located primarily in the United Kingdom, Spain, the Netherlands and France; and concentrated principally in banking and finance, food products and chemicals. The key location for outward investment is the US, followed by EFTA; the United Kingdom, the Netherlands and France are the main sources; and the investment goes mainly into energy, chemicals, machinery and transport equipment, and banking and finance.

Japan is now the key marginal supplier of inward investment, with most flowing to the United Kingdom and the Netherlands. Recent Japanese FDI has been predominantly in non-manufacturing, especially finance and insurance.

FDI occurs when firms have proprietary assets like reputation or brand image which they wish to exploit in a particular location. The presence of market imperfections of one form or another leads firms to invest directly to exploit such assets, rather than licence their product/technology, or engage in arm's-length trade.

FDI promotes international specialization, thereby promoting static and dynamic gains. On some counts, concern is sometimes expressed regarding the activities of multinational enterprises (MNEs). Typically this focuses on the quality and quantity of employment generated, trade balance effects and income redistribution through transfer pricing. In general these anxieties are exaggerated, and the evidence suggests that the Community has benefited from inward investment.

Because of the crucial contribution which investment formation makes to economic growth, policy-makers often attempt to influence the level or composition of aggregate investment. To this end, a wide array of policy instruments can be deployed.

Investment policy may operate through direct investment measures, or trade-related investment measures. The former are generally incentive measures, the latter disincentive. It is quite common to see both sets of instruments operating simultaneously, especially in developing countries. The conjunction of both makes it difficult to evaluate their welfare consequences. It is clear, however, that many of these instruments have direct trade effects.

The 1992 programme represents a regime change in the Community. The programme has stimulated a great deal of cross-border investment within the Community. It has also stimulated an upsurge in inward investment, as MNEs attempt to position themselves to exploit the benefits of bridgehead investment and/or rationalization investment. The potential rents associated with the ownership advantages of Japanese firms in particular have been enhanced by 1992 measures and led them to invest more in Europe than would otherwise be the case.

Once the single market measures are implemented in full, the scope for independent policy actions on the part of Member States will be further constrained. Should there be adjustment pressures in particular sectors, as is likely, the governments of Member States may come under pressure to take action. This may provide a temptation to use investment policy to attract inward investment to the affected sectors/regions. This necessitates attention being paid to the issue of policy coordination across Member States.

Policy compatibility is also an important issue. Different policy instruments can have equivalent effects. Unless compatible policies are in place, policy conflict can arise to avoid negative feedback across policies, and agencies.

Policy conflict between the EC and other countries is also important given the scope for intervention elsewhere. A range of regional and multilateral arrangements or codes have been arrived at, directed largely at setting standards rather than influencing behaviour.

The inclusion of trade-related investment measures (TRIMs) and subsidies as agenda items on the Uruguay Round offer the opportunity for GATT to become more directly involved in specifying multilateral disciplines to govern the use of investment measures. However, a more rules-based system is necessary for such a role to be fulfilled.

Progress within the GATT cannot be secured by attempting to transpose the provisions which apply to merchandise

[1] An earlier draft of this paper benefited from discussion at a European Commission workshop in Brussels. The comments of the paper's discussant, Silvano Presa, were especially helpful. The author above is responsible for its contents.

trade to investment. However, the principles on which trade disciplines are based, most notably national treatment and mutual recognition, should provide the foundation to new disciplines for investment measures. GATT can learn from progress made on intra-Community cross-border investment in this respect.

1. Introduction and outline

Why, in the context of a trade study, are we interested in investment issues? There are both analytical and policy-based responses to this question. A number of analysts have commented upon the contemporaneous growth of cross-border trade and cross-border investment — indeed in recent years growth of the latter has outstripped the former. Moreover, it does appear to be the case that the growth in foreign direct investment (FDI) has been especially rapid in a setting of formal integration arrangements. It can, therefore, be expected that as market integration proceeds in the Community there will be increased intra-EC cross-border investment, and increased investment in the Community from non-member States. In turn, this raises some pertinent and interesting policy issues: the harmonization of regulatory and incentive structures across Member States is one; the interface between regulation of intellectual property rights, services, competition policy and investment is another; and then there is the pressures for multilateral disciplines. Together these combine to make investment a major policy issue, especially from an EC perspective.

This paper aims to document trends in FDI, evaluates analytical issues concerned with the regulation of investment flows and considers policy compatibility with other measures, all with particular reference to the Community. The paper is organized as follows. Section 2 focuses on trends and patterns in FDI. Here we examine both global and regional trends. In Section 3 we review the determinants of FDI, and the factors which influence the net benefits of a particular inward investment. Section 4 is concerned with policy towards investment. From an EC standpoint this involves both internal measures, and measures *vis-à-vis* non-Community entities. It also involves both investment incentives and disincentives. In Section 5 we consider how Europe 1992 and the completion of the internal market can be expected to impact on inward investment. This sets the agenda for Section 6 where the focus is policy coordination in the Community. Since EC trade and investment policies are set against the wider firmament of multilateral rules and disciplines, Section 7 concentrates on activity in the GATT and OECD. Finally, Section 8 offers some concluding comments.

2. Trends in investment

The post-war period has seen an extraordinary growth of world trade, and this growth has been well documented (for example in annual GATT reports). Over the same period there has been a concomitant growth in foreign direct investment, which has in fact been less well documented — in part due to data deficiencies, in part because of problems of separating out stocks and flows. Recent data shows evidence of impressive growth, especially over the last decade. As can be seen from Table 52, the total world stock of FDI is now well in excess of USD 1 trillion. The reasons for the contemporaneous expansion of trade and investment, especially over the last decade, are not hard to find. There are 'natural' linkages between the two flows — since a large proportion of international trade is intra-firm trade, investment naturally leads to trade expansion. Moreover, the globalization strategies of multinationals in general, and East Asian multinationals in particular, have been facilitated by deregulation of financial markets.

Graph 25 gives details of the regional composition of investment flows across the three largest trading bodies — the United States of America, Japan and the European Community. As can be seen, the Community is both the major source and the major recipient of FDI, with a particularly large stock in the United States. The latter is also a major recipient and source of FDI, with most US investment being in the Community. Japan is of growing importance as a supplier of FDI but not as a recipient. It is in fact the fastest growing supplier of foreign investment, but there is a very significant imbalance between inflows and outflows with both the USA, and the Community.

Since the focus of this paper is the Community, Graphs 26 to 32, and Tables 53-55 document trends and patterns. From Graph 26 we can see that FDI in the Community has grown steadily since 1970, with step increases associated with enlargements (e.g. in the mid-1970s, due largely to the accession of the United Kingdom, and mid-1980s, due largely to Spanish accession), and market deepening (in the case of the latter part of the 1980s). In Graph 26, FDI inflows as a proportion of GDP are documented. Here we can see a relatively flat trend over the period 1970 through 1984, albeit with peaks and troughs around it, and a dramatic increase since the mid-1980s. The latter is dominated by inflows of FDI from Japan, and has in part been motivated by expectations associated with the 1992 programme.

Graph 27 details the sources of inward investment to the Community. This is dominated by OECD countries in general and EFTA, the USA and Japan in particular. The last

Table 52

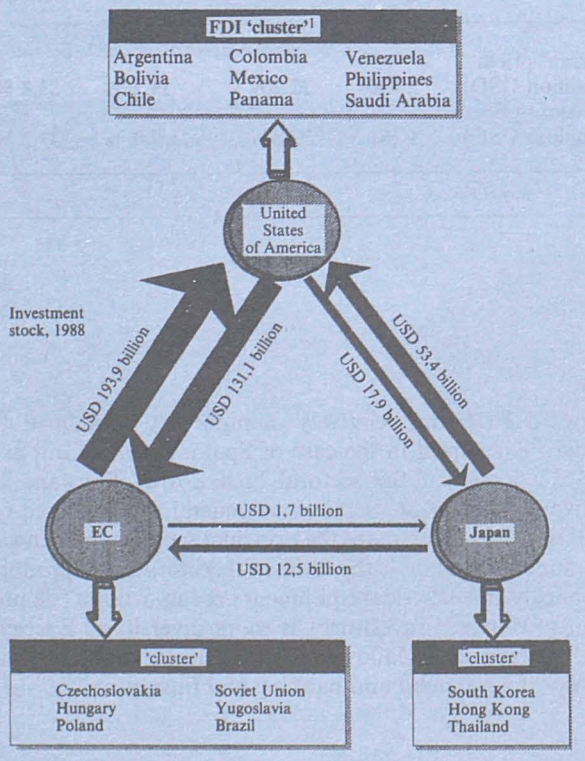
The share of leading investors in world stock of FDI

(in billion USD)

	1960	(%)	1980	(%)	1985	(%)	1988	(%)
World Stock	67,7	100,0	551,0	100,0	714,0	100,0	1 101,0	100,0
USA	31,9	47,1	220,3	40,0	250,7	35,1	334,0	30,3
Japan	0,5	0,7	36,5	7,0	83,6	11,7	186,0	16,9
UK	12,4	18,3	81,4	14,8	104,7	14,7	179,0	16,3
Germany	0,8	1,2	43,1	7,8	60,0	8,4	90,0	8,2
Switzerland	2,3	3,4	38,5	7,0	45,3	6,4	55,0	5,0
Netherlands	7,0	10,3	41,9	7,6	43,8	6,1	61,0	5,5
Canada	2,5	3,7	21,6	3,9	36,5	5,1	52,0	4,8
France	4,1	6,1	20,8	3,8	21,6	3,0	51,0	4,6
Italy	1,1	1,6	7,0	1,3	12,4	1,7	23,0	2,1
Rest of world	5,1	7,6	39,9	6,8	55,4	7,8	71,0	6,3

Source: UN Centre on Transnational Corporations (1990).

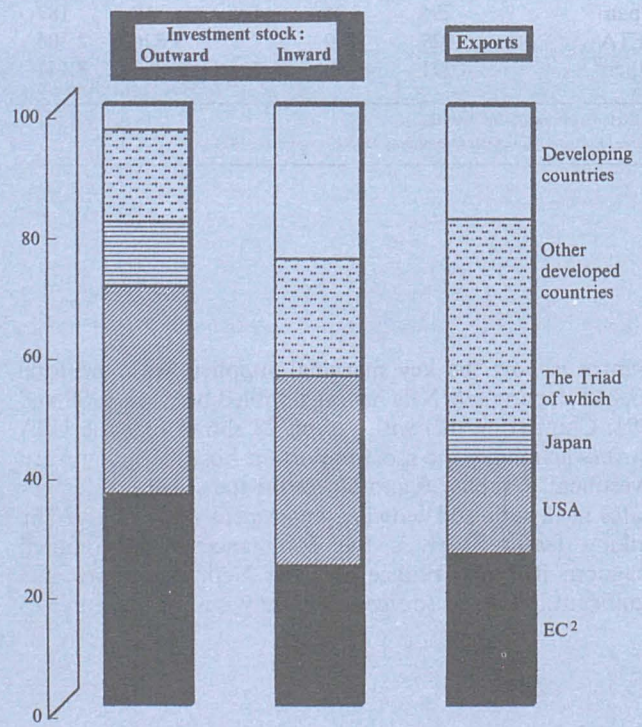
GRAPH 25: Foreign direct investment



[1] Selected countries where a single Triad member accounts for over 50% of inflows of FDI, or is the single biggest investor by a margin of 10 percentage points.

Source: The Economist.

World foreign direct investment and trade by region, percentage of total, 1988



[2] Excludes intra-EC investment and exports.

Sources: UNCTC, IMF.

Table 53

Inward direct investment of the Community

(million ECU)

	1984	1985	1986	1987	1988
World[1]	6 177	5 637	6 805	12 578	14 278
of which:					
USA	2 919	1 766	2 484	2 356	606
Japan	390	646	445	1 502	1 461
EFTA	1 661	1 666	3 267	3 543	9 021
Others	1 207	1 559	609	5 177	3 190

[1] Excluding intra-EC investments.

Source: Eurostat, European Community Direct Investment, 1984-88.

Table 54

Outward direct investment of the Community

(million ECU)

	1984	1985	1986	1987	1988
World[1]	17 395	15 349	22 164	30 780	30 711
of which:					
USA	11 650	10 063	17 662	23 901	20 074
Japan	295	36	116	18	187
EFTA	929	760	9	1 826	2 306
Others	4 521	4 490	4 395	5 035	8 144

[1] Excluding intra-EC investments.

Source: Eurostat, European Community Direct Investment, 1984-88.

Table 55

Annual flows of Japanese FDI, 1974-89

(million USD)

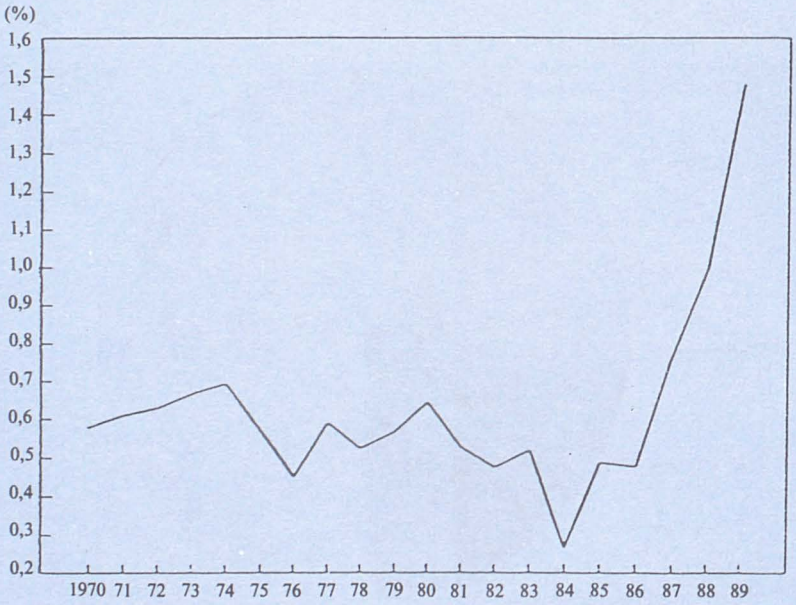
Year	Current prices	Constant 1980 prices
1974	2 396	4 608
1975	3 280	5 655
1976	3 462	5 969
1977	2 806	4 384
1978	4 598	6 673
1979	4 995	6 077
1980	4 693	4 693
1981	8 932	9 087
1982	7 703	8 265
1983	8 145	9 162
1984	10 155	11 713
1985	12 217	14 322
1986	22 320	25 479
1987	33 364	34 396
1988	47 022	46 100
1989	67 540	65 572

	Annual average flows		Annual average growth rate	
	1974-79	1980-89	1974-79	1980-89
Current prices (million USD)	3 590	22 209	19,2 %	33,8 %
Constant prices (million USD)	5 561	22 879	9,0 %	31,2 %

Source: Ministry of Finance, Japan.

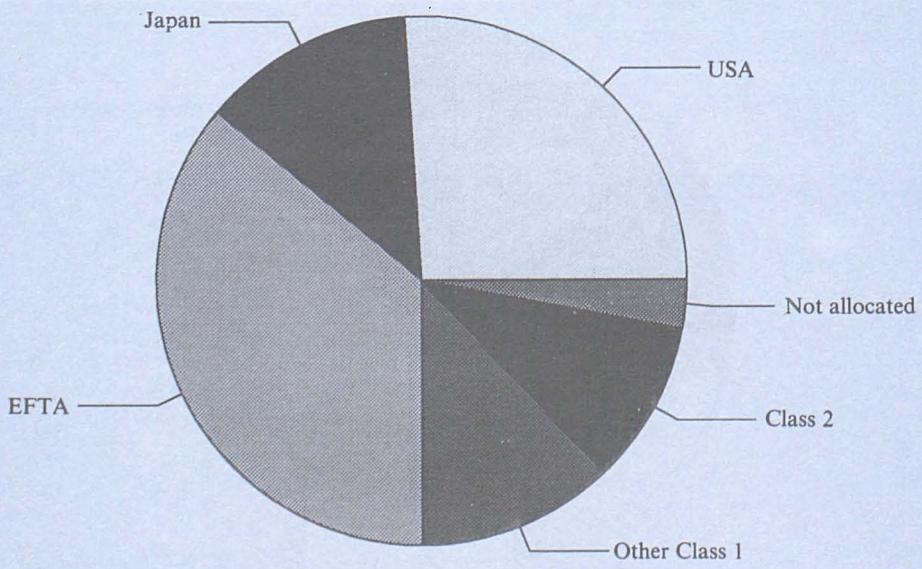
country is now the key marginal supplier, with the total stock of Japanese MNEs having doubled between 1988 and 1991. Comparing this with Graph 28 shows that the USA is overwhelmingly the most important host to EC outward investment. Graphs 29 and 30 record the share of Member States in inward and outward investment respectively. The striking feature here is the dominance of the United Kingdom in both. France and the Netherlands are also significant hosts and sources. Germany is a major source of outward FDI, but relatively unimportant as a host; this pattern is reversed in the case of Spain. Finally, Graphs 31 and 32 document the sectoral breakdown of inward and outward investment. Services in general, and finance and banking in particular, are the principal sectors where inward investment occurs. Of the industrial sectors, food products, chemicals and electrical equipment are important. The portfolio of outward investment is more diversified. Energy is the largest sector, followed by chemicals, machinery and transport equipment and banking and finance.

GRAPH 26: **EC FDI inflows 1970-89 as a percentage of GDP**

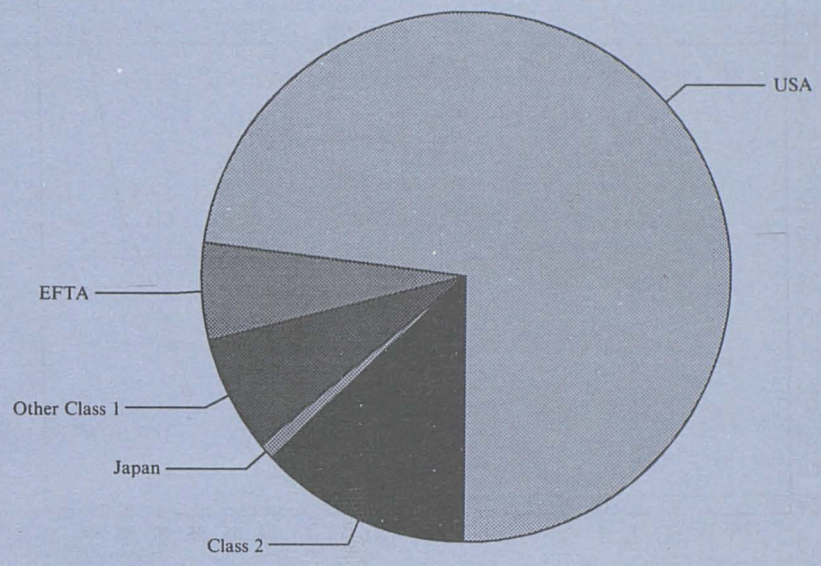


Source: Thomsen and Nicolaides (1991).

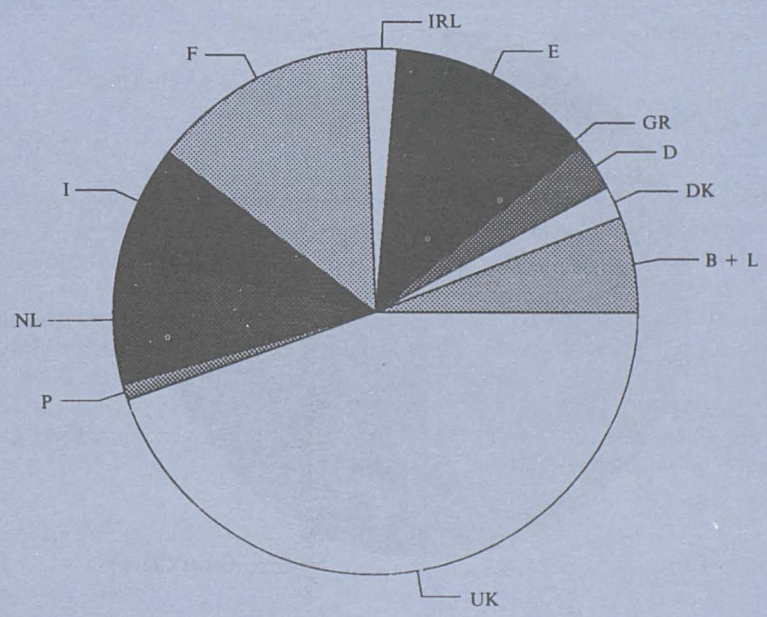
GRAPH 27: **Geographical breakdown of inward direct investment of the Community (1984-89 average)**



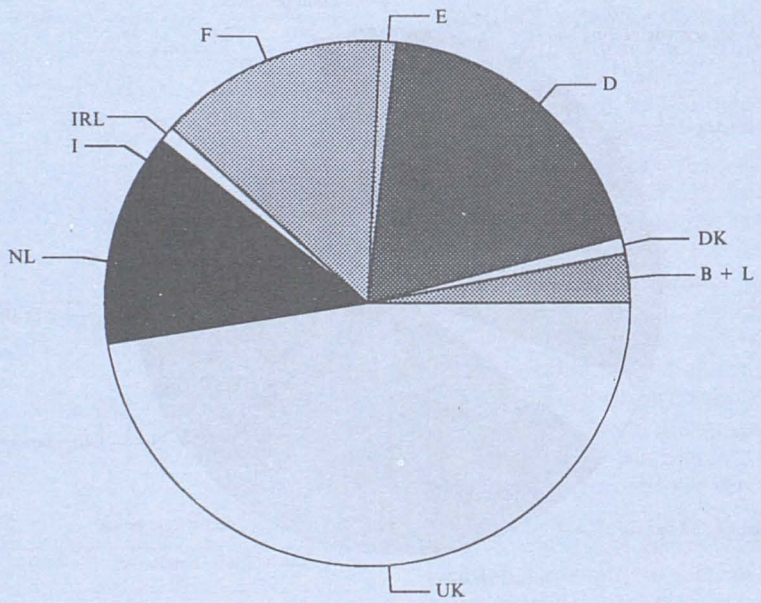
GRAPH 28: **Geographical breakdown of outward direct investment of the Community (1984-89 average)**



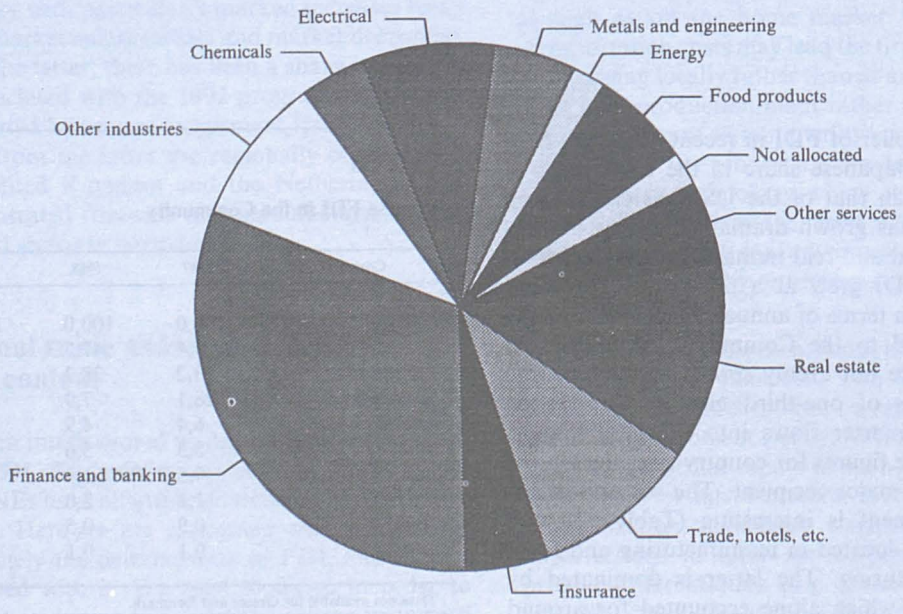
GRAPH 29: **Share of each Member State in inward direct investment of the EC (1984-89 average)**



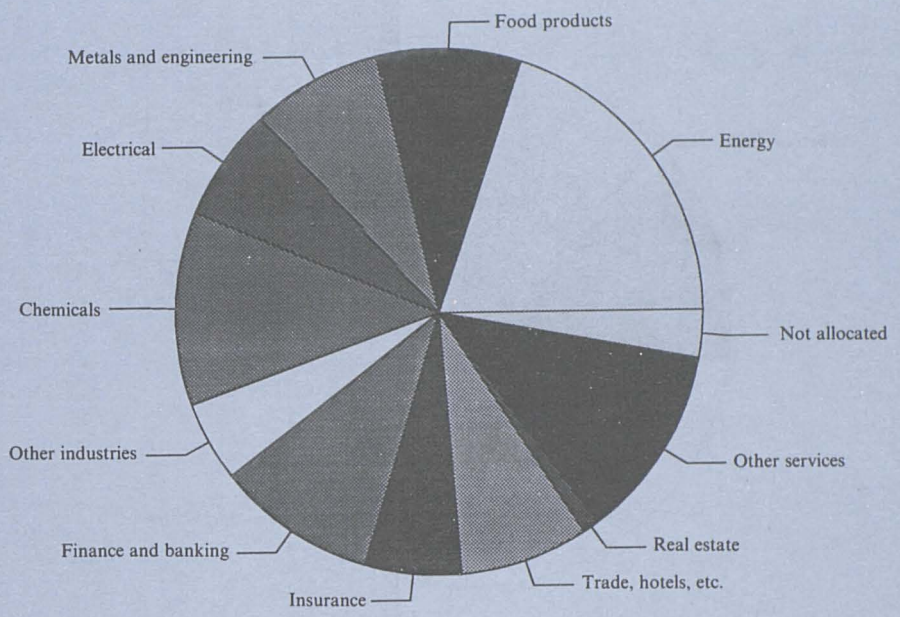
GRAPH 30: **Share of each Member State in outward direct investment of the EC (1984-89 average)**



GRAPH 31: **Sectoral breakdown of inward direct investment of the Community (1984-89 average)**



GRAPH 32: **Sectoral breakdown of outward direct investment of the Community (1984-1989 average)**



The key marginal supplier of FDI in recent years has been Japan. Although the Japanese share in the total stock of FDI is still smaller than that of the USA, as can be seen from Table 55, FDI has grown dramatically over the last decade both in nominal and real terms. Over the decade of the 1990s Japanese FDI grew at a remarkable 30% per annum in real terms. In terms of annual flows, it is now the major supplier of FDI to the Community. As Table 56 shows these inflows are not evenly spread throughout the Community. In excess of one-third goes to the United Kingdom, a further quarter flows into the Netherlands. Even if one scales these figures for country size, the United Kingdom remains the major recipient. The sectoral distribution of this investment is interesting (Table 57) with around one-fifth being located in manufacturing and four-fifths in non-manufacturing. The latter is dominated by finance and insurance which alone accounted for around half of all Japanese FDI in 1989.

Table 56

Japanese FDI in the Community

(%)

Country[1]	1987	1988	1989	1951-89
EC	100,0	100,0	100,0	100,0
UK	39,4	47,5	37,4	37,7
Netherlands	13,2	28,3	32,4	24,1
Luxembourg	28,1	7,9	4,7	3,0
Germany	6,4	4,9	7,7	8,2
France	5,3	5,6	8,1	6,9
Spain	4,5	1,9	3,6	3,7
Belgium	1,1	2,0	2,3	3,2
Ireland	0,9	0,5	1,0	1,3
Portugal	0,1	0,1	0,5	0,3

[1] Data not available for Greece and Denmark.

Source: Ministry of Finance, Japan.

Table 57

Sectoral distribution of Japanese FDI in the Community

(%)

	1986	1988	1989
Manufacturing	17,0	16,0	18,0
of which:			
metals	1,8	1,1	0,9
chemicals	1,6	2,0	2,5
electrical machinery	3,6	4,2	4,5
transportation equipment	3,4	3,0	3,0
textiles	1,5	1,0	1,1
general machinery	1,9	2,1	3,0
Non-manufacturing	83,0	84,0	82,0
of which:			
mining	6,2	3,6	3,1
commerce	19,9	13,1	12,0
finance and insurance	41,3	49,2	47,3
transport	0,3	0,3	0,3
Total (billion USD)	14,5	30,2	50,0

Source: Ministry of Finance, Japan.

In summary, as well as being the world's largest source of FDI, the Community is also the world's largest recipient (even if one nets out intra-Member State cross-border investment). Inward FDI has grown steadily since the formation of the Community with particularly marked increases being associated with market enlargements and market deepening. With respect to the latter, there has been a sharp increase in inward FDI associated with the 1992 programme, and this has been dominated by inward investment from Japan. Investment flows from the latter are regionally concentrated (towards the United Kingdom and the Netherlands) and sectorally concentrated (towards non-manufactures in general, the financial sector in particular).

3. International trade and capital flows: analytical context

The links between international trade and capital flows, the forces driving FDI, the benefits and costs of FDI and the operation of MNEs have all attracted detailed and extensive analytical work. Here we are concerned with a subset of these issues, namely the determinants of FDI, and the net benefits associated with it. We need to do so in order to understand what is driving the current upsurge in inward investment to the Community, and its potential.

3.1. Determinants of FDI

A wide range of models have focused on the issue of what motivates firms to engage in FDI rather than arm's-length trade (for a review see Cantwell, 1992). Results depend upon model specification and, in turn, this is fashioned by the precise features of what is after all a very complicated process. Although many results are therefore model specific it is possible, as Dunning (1988) has shown, to organize and summarize the factors which drive foreign investment under the 'eclectic paradigm'. According to this, the decision to engage in local production and/or intra-firm trade, rather than license, or engage in arm's-length trade is driven by considerations of ownership, location and internalization. What this so-called OLI paradigm claims is that conditions under all of these headings must be met before FDI will occur. In other words, although it may be necessary for a firm to have certain ownership advantages before it considers overseas investment, this in itself is not sufficient. Likewise, although it may be desirable that the market in which a subsidiary is located have certain characteristics, again this in itself is not sufficient. The sufficiency condition is that it must be infeasible for the firm to exploit ownership and locational advantages without recourse to the internal markets which FDI creates.

Take a specific example of a firm which has a valuable proprietary asset — say a strong brand image. The positive rate of return which this yields confers an ownership advantage. Now suppose there is a foreign market with no competing brand where this asset can yield a rate of return at least as high as on the home market. Production conditions/transportation costs may lead the firm to decide on a strategy of supplying locally rather than at arm's-length. Why should it set up a production plant rather than license? One possibility is to ensure certain quality control conditions are met. Alternatively the proprietary product may be produced by a proprietary technology which the firm wishes to retain control of. Either way the result is the same: to fully exploit the ownership/locational advantages the firm has to internalize the transaction by setting up a production facility.

Table 58 lists possible ownership, locational and internalization advantages. Associated with the former there may be advantages attached to size, or intangible assets like reputation or government policy. Where location is concerned, access to particular inputs or economies of scale or government policy or infrastructural factors might be important. Internalization advantages might derive from failures or imperfections in input or output markets. Alternatively product differentiation or government policy can all play a role. The great advantage of this eclectic paradigm is that is provides a general explanation for FDI which encompasses

all other model-specific theorems. In the context of FDI in the Community there are a number of locational advantages which are/have been influential. These are only provided in Table 59 for illustrative purposes at this stage. In Section 4 we will investigate EC factors in more detail.

3.2. Net benefits of FDI

FDI can stir strong emotions — especially when 'national interest' or 'strategic' issues are seen as being at stake. Analysis of the welfare impact revolves around, *inter alia*, employment effects; externalities; income redistribution; and trade balance effects. Each issue is controversial.

Employment effects. How does FDI affect aggregate employment, and the composition of employed labour? Opponents argue that FDI must be employment reducing. Their argument is as follows: foreign firms replace local firms as suppliers of final goods, and typically the former rely on imported inputs to a greater extent than the latter. Moreover, it is sometimes also argued that those jobs which are created are low value-added/low human capital intensive jobs. Evidence from the USA does suggest that foreign MNEs in general and Japanese MNEs in particular are more import-intensive than indigenous firms (see for instance Lipsey, 1991; Graham and Krugman, 1991). However, this does not necessarily mean that they will be a source of net employment decline. As Graham and Krugman (1991) point out aggregate employment has much more to do with supply side conditions, in particular the occupational and geographical mobility of labour. Indeed, in so far as inward investment results in changes in work practices in indigenous firms, it may even impact favourably on aggregate employment. In the European context, a strong case can be made to the effect that the net impact of the US multinationals on aggregate employment has been favourable. Besides which, the higher import intensity of Japanese production may be a transient phenomenon which changes once local networks are established.

The 'quality of employment' argument is no more serious. Critics argue that MNEs basically set up 'screwdriver' plants geared towards low value-added, low-wage functions. Longer term evidence from US investment in Western Europe, and more recent evidence on Japanese investment in the USA, suggests that this is not in fact generally the case.

Externalities. It is possible to argue that FDI has positive spillover effects through its impact on technology transfer. The contribution of modern endogenous growth theory has been to provide an explicit role for technology in the growth process. FDI is an obvious source of embodied technology

Table 58

The OLI paradigm

Ownership advantages

(a) Size
Obtain inputs more cheaply or exclusive access to inputs
Better access to product markets
Product or process diversification
Economies of scale, both at plant-level and firm-level

(b) Intangible assets
Proprietary knowledge, technology, trade marks, product management, marketing, R&D, bank of human capital

(c) Government
Policies which favour business in home country

Location advantages

(a) Inputs
Spatial distribution of inputs and markets
Input prices, quality and productivity

(b) Economies of scale
Extent to which plant-level economies of scale make for centralization of production

(c) Government
Government intervention
Control of imports (tariffs, etc.), tax rates, incentives, investment climate, political stability

(d) Other
Transport and communications costs
Infrastructure (commercial, legal, transportation)
Psychic distance (language, culture, business, customs)

Internalization advantages

(a) Market failure in market for final goods
Reduce costs associated with market transactions
Compensate for absence of futures markets

(b) Market failure in market for inputs
Avoid costs of enforcing property rights
Buyer uncertainty about nature and value of inputs
Control supplies and conditions of sale inputs

(c) Monopoly power
Where market does not permit price discrimination
Control market outlets
Engage in anti-competitive practices such as cross-subsidization and predatory pricing

(d) Product differentiation
Need of seller to protect quality of product

(e) Government
Avoid or exploit government intervention (quotas, tariffs, taxes, price controls)

Source: adapted from Dunning, 1988.

Table 59

Locational advantages in the Community

Advantage	Applicability to		Comments
	Community	Individual Member State	
a. Inputs			
Price		√	Especially important in Southern States
Non-price	√		Especially important in Northern States
b. Economies of scale	√		Given additional importance by 1992 and single market
c. Government policy			
Investment incentives		√	Range of incentives offered, especially in 'regions'. May become more important after 1992
Protected markets		√	May have been a mechanism for side-stepping source-specific restraints
Expectation of fortress Europe	√		Concern regarding fortress Europe may have stimulated FDI
d. Infrastructure			
Political	√		Stability conducive to investment
Transport and communications	√		Good communications and transport systems conducive to investment

— cross-border investment is potentially a major stimulus to growth. In an EC context this is one of the factors which leads Baldwin (1989) to identify such spectacular gains from the 1992 programme. Clearly it is not peculiar to FDI which originates within the Community. There is some evidence to suggest that in some sectors (e.g. automobiles) foreign firms install best practice technology and management techniques and that these trickle down to local producers.

Trade balance effects. Concern here derives from the allegedly high import dependence of foreign firms, combined with the allegedly low value-added nature of the operations. The combination of these impacts adversely on the trade balance. As noted earlier, there is some evidence from the USA (Lipsey, 1991; Graham and Krugman, 1991), and from Australia (Kreinin, 1988), to the effect that Japanese firms tend to have a higher import dependence than local firms. Balasubramanyam (1988) among others has argued that this is in fact just a temporary phenomenon. Once the foreign firm becomes established it sets up local supply networks for sourcing inputs. Moreover, the initial investment itself often brings in its wake subsequent investments from downstream producers. Another response is to point out that the goods which are actually produced may replace imports rather than domestically produced import substitutes. This has probably been the case in consumer electronics and automobiles. Finally, the key point to note is that fundamentally it is macroeconomic factors which are responsible for the trade balance at a particular point in time. Specifically, it is driven by savings and investment imbalances across trading partners. Even if a particular investment resulted in net imports, it would ultimately be offset by the export stimulus induced by lower exchange rate. (This of course only applies to investment flows from outside the Community. With exchange rates between Member States fixed, the same equilibrating mechanism does not operate.)

Income redistribution. We noted in the previous subsection how crucial the presence of internal markets is to FDI. Typically, because market imperfections preclude a potential supplier from fully appropriating the returns to firm-specific assets, FDI allows certain transactions to be internalized. However, the existence of such internal markets creates opportunities for MNEs to engage in transfer pricing. By so doing they can minimize their tax liability in the host economy. In so far as this results in revenues which would otherwise accrue to the host government leaking overseas, it represents a welfare loss. There is evidence from developing

countries which shows that transfer pricing does occur on a non-negligible scale. The same kind of evidence is not available for the Community or North America. This could represent a lack of appropriate empirical work. However, the practice is likely to be less important in the Community and North America for three reasons: first the range of controls and restrictions which stimulate the practice are nothing like as pervasive as in developing countries; second double taxation agreements are more common; third disclosure rules are tighter.

Summary. FDI, like international trade, promotes the specialization process. As with international trade, one can identify static gains (through resource reallocation), and dynamic gains (through exploitation of scale economies, pro-competitive effects on local markets, and a stimulus to growth), which are a corollary of the process. As we have seen, it is possible to argue that, on some counts, there may be costs associated with FDI. Clearly the net employment effects, or trade balance effects, will vary from one industry to another, depending upon supply conditions, market structure and so on. Overall, however, there is a strong presumption that FDI confers net benefits. In the context of the Community this has never really been an issue, given the volume of cross-border FDI between Member States, and the fact that the Community is both the largest supplier and recipient of FDI. On occasions concern has been voiced at inflows from particular sources (the USA in the early 1960s; Japan more recently). None the less, this has not been as intense as elsewhere, no doubt because the Community is a major source of FDI, as well as a major host.

4. Policy towards investment

Investment is a key determinant of economic growth. Although there may be disagreement among policy-makers and analysts regarding the exact relationship between investment and growth, the fact that there is a direct relationship is beyond dispute. This being so, policy-makers strive to create an environment which is conducive to investment formation. The pervasiveness of investment codes in developing countries and the diversity of investment incentives in industrialized countries is testimony to this. Historically investment measures have been regarded as a non-border issue. When economies were relatively closed this was a reasonable simplification. However, with the remarkable growth of trade over the post-war period, and the concomitant globalization of production discussed earlier, the border/non-border distinction has become increasingly meaningless. The fact that trade-related investment measures (TRIMs) were an agenda item in the Uruguay Round is a reflection of this.

From an EC standpoint this is a two-track issue involving internal measures which might influence cross-border investment, and measures *vis-à-vis* non-EC entities. Both will be examined in greater detail later. For the moment we focus on the range of instruments which can be deployed to influence the level and composition of investment, their usage and their economic effects.

4.1. Investment incentives

Investment formation is often viewed as an appropriate area for public support. Many initiatives to encourage capital investment are economy-wide, regionally based or sectorally based. These can take the form of accelerated depreciation arrangements for all new capital investment (economy-wide); or regional initiatives, such as the old regional employment premium in the United Kingdom; or less commonly they may be intended to alter the relative returns to investment across sectors, like the selective employment tax which operated in the United Kingdom in the 1960s. Such interventions tend not to discriminate between indigenous and foreign investment. In addition and/or instead of these provisions it is not unusual to find incentives targeted specifically at MNEs considering FDI.

The rationale behind discriminatory arrangements is threefold: first, it presumes that FDI supplements indigenous investment, and no crowding out takes place; second, it presumes that there are net benefits to the host economy arising from FDI; third it presumes that the supply of FDI is responsive to incentives. We will comment on the veracity of these assumptions later. For the moment, let us be more specific about the kind of incentives which host governments typically offer to MNEs.

Table 60 lists a range of instruments of investment policy, and their intended effects. Instruments are classified according to whether their initial impact is aimed at the input or output side. A common incentive is the duty drawback. This allows the MNE to claw back any import duties (and possibly other charges) on imported inputs. If successful the drawback operates as an input subsidy and raises the effective rate of protection to the production process. Tax exemptions on equipment operate in a similar fashion. The exemption, however, would apply whether the materials were purchased locally or imported. Clearly this is a capital subsidy, the value of which is higher the more capital-intensive the production process. Equally clearly, in the absence of offsetting labour subsidies, it is likely to have the by-product distortion of stimulating more capital-intensive production techniques. Investment allowances which can take various forms operate in a similar fashion, as does accelerated de-

preciation. The latter allows the investor to bring forward depreciation allowances to the early years of the investment, with a view to easing cash flow problems.

Table 60

An inventory of investment incentives

Input incentives	
Instrument	*Intended effect*
Duty drawback	Subsidy on imported inputs
Tax exemptions on equipment	Input subsidy
Accelerated depreciation	Subsidy to capital equipment
Investment allowances	Subsidy to capital equipment
Training credits	Subsidy to human capital formation
R&D support	Encouraging high technology
Output incentives	
Instrument	*Intended effect*
Export subsidy	Specifying that exported output gain bounty
Tax holiday	Exempting profits from taxation for specified period
Market reserve commitments	Local market monopoly conferred on investor
Export retention schemes	Allow MNE to retain foreign exchange earnings

Training credits often take the form of tax allowances for training programmes or staff development programmes. Thus the MNE reclaims, in whole or in part, the costs of a particular programme, or offsets it against tax liabilities. The intention here is to encourage the formation of human capital. In so far as there may be first mover disadvantages associated with endowing labour with sector-specific skills, this instrument can also be an optimal response to a common externality. The same can be said of R&D subsidies. Here the MNE is allowed to offset investment in R&D against tax liabilities or receives a direct subvention for R&D. As well as aiming to attract technology-intensive firms, such an instrument is also directed at encouraging MNEs to transfer part of the innovation process to the subsidiary.

Input incentives tend to be more widespread than output incentives, for obvious reasons — capital formation is what is being encouraged. Input incentives provide support at an early stage in the production process and transparently raise the effective protection conferred on the firm. However, some output incentives are deployed. For instance, some developing countries offer direct export subsidies to MNEs, often when the investment is in an export-processing zone (EPZ). The intention is clearly not only to encourage investment *per se*, but investment in a particular sector. Direct export subsidies are of course illegal under GATT. Market reserve commitments are often given to provide the MNE with a local monopoly. Frequently, in developing countries, these will be tied to an obligation to export. In effect the MNE is being allowed to cross-subsidize. Analytically the tying functions like an export subsidy, with the subvention being provided by local consumers to the product in question, rather than the domestic exchequer. Export retention schemes can also operate as a form of export subsidy. Where foreign exchange rationing operates, it is not unusual to find regimes where export earnings have to be sold to the domestic central bank at the official exchange rate. Clearly, if the exchange rate is overvalued, this operates as an export tax. Freedom to retain all, or part of export earnings, in effect permits the firm to trade at the shadow exchange rate, and *vis-à-vis* indigenous firms, provides an export subsidy. Finally, many governments offer tax holidays. Typically these offer a tax amnesty for a designated period of time. Clearly this is aimed at subsidizing the entire operation and changing the attractiveness of one investment location *vis-à-vis* another.

Table 61 summarizes empirical evidence on the incidence of investment incentives. As can be seen, they tend to be more prevalent in developing than industrialized countries; tend to be geared towards input rather than output support; tend to be targeted at encouraging investment in the export sectors in developing countries, and in high-tech sectors in industrialized countries; and are frequently used as an instrument of regional or social policy.

Table 61

Incidence of investment incentives

Investment incentives are often used in a non-discriminatory fashion as instruments of regional or social policy.

Input incentives are more prevalent than output incentives.

Incentive programmes are often enshrined in investment codes in developing countries.

Reliance on discretionary incentives is more prevalent in developing countries than industrialized countries.

Developing countries make widespread use of incentives to attract MNEs into export sectors.

Industrialized countries commonly provide support to encourage investment in R&D-intensive sectors.

4.2. Trade-related investment measures

The declaration which initiated the Uruguay Round drew specific attention to the need to examine the applicability of GATT articles to '... the trade restricting and distorting effects of investment measures ...'. What are these measures? Table 62 provides details of TRIMs classified on an input-output basis.

Perhaps the most pervasive of investment measures are various forms of local content requirements. These specify that some proportion of value-added, or of intermediate inputs, must be locally sourced. If local inputs are higher cost than their imported counterparts, then this particular instrument has obvious trade effects. Trade balancing requirements can take a variety of forms. They could for instance link imports of one product (e.g. an input) to a specified performance on exports of some other product, which could be the final good. Again the instrument has clear trade effects. Laws of similars require foreign investors to use local substitutes for imported inputs if a 'similar' component is manufactured locally. Clearly, if an MNE would otherwise import the input, the trade restricting and distorting effects are obvious. Limitations on imports, generally by quota, accomplish the same end, though by a slightly more transparent route, and are self-explanatory, likewise with foreign exchange restrictions. These are often directed at constraining an investor in terms of the amount of intermediate inputs which can be imported.

Local equity participation is a common precondition for investment, which like local hiring targets, expatriate quotas and national participation in management, is designed to indigenize part of the operations of the affiliate. The trade effects of these requirements are less obvious than those discussed above. Both R&D requirements and technology transfer requirements distort the type of investment undertaken, and the firm's commitment to technology transfer. These may reduce import requirements, and/or limit opportunities to export. Earnings remittance limits typically restrict the amount of profit which can repatriated. In turn this can result in a diversion of earnings into investment for local production.

The most frequently reported form of output intervention is minimum export requirements. Where this intervention is effective, it can have potentially serious trade effects — exports would be higher than otherwise, resulting in trade deflection elsewhere. Trade balancing requirements can operate in a similar fashion by compelling the investor to export more of its output than it would do otherwise. Less common is export controls directed at ensuring that exports of specified commodities are precluded, or restricted. Market reserve policy is applied when the local market is reserved

Table 62

An inventory of TRIMs

Input TRIMs

Instrument	*Intended effect*
Local content requirements	Specifying that some proportion of value-added or intermediate inputs be locally sourced
Trade-balancing requirements	Linking imports of one product to export performance of some other
Laws of similars	Requiring MNEs to use local substitutes for imported inputs if a 'similar' component is locally manufactured
Limitations on imports	Self-explanatory
Foreign exchange restrictions	Constraining investor in terms of amount of intermediate inputs which can be imported
Local equity participation	Specifying that some proportion of equity must be shed locally
Local hiring targets Expatriate quotas National participation in management	Ensuring specified employment targets are hit
R&D requirements	Committing MNE to investment in R&D
Technology transfer	Committing MNE to local use of specified technology

Output TRIMs

Instrument	*Intended effect*
Minimum export requirement	Specifying a certain proportion of output to be exported
Trade-balancing requirements	As above
Export controls	Specifying that certain products may not be exported
Market reserve policy	Specifying that local market is reserved for local producers
Product-mandating requirements	Obliging the investor to export the mandated product from host country only
Licensing requirements	Obliging investor to licence production of output in host country
Technology transfer	Committing MNE to specified embodied technology

for actual, and sometimes even potential, producers of a competing product. If it locks the affiliate into exporting rather than supplying the domestic market, again it has clear trade effects. Product mandating requirements oblige the investor to export the mandated product from the host country only. Depending upon the level of demand to be satisfied globally, and the parent company's global investment strategy, this could lock the MNE into exports from higher cost locations. These differ from licensing requirements which oblige the investor actually to license production of the output in the host country. Table 63 summarizes the evidence on incidence of TRIMs.

Table 63

Incidence of TRIMs

The principal TRIMs are local content requirements and minimum export requirements.
About one-sixth of (US) affiliates are subject to TRIMs.
The incidence of TRIMs in developing countries is four times that in developed market economies (DMEs).
TRIMs are more heavily concentrated in mining and manufactures than in services.
The main sectors in manufactures are automobiles, high-tech and petrochemicals.
The principal developing countries in terms of incidence are Brazil, Mexico, India and Nigeria.
The principal DMEs in terms of incidence are Canada, Australia and Spain.
There is a tendency towards rules-based regimes in some developing countries.
There is a high correlation between positive investment incentives and TRIMs.
There is a high correlation between import protection and TRIMs.

TRIMs are intended to accomplish three things: first, to influence the location and pattern of economic activity; second, to ensure that the likelihood of benefits which the host government wishes to secure is greater than it otherwise would be; and third, to redistribute part of the surpluses generated by FDI away from the MNE and towards residents of the host country. We will refer to these as the resource allocation target, the insurance target, and the rent-shifting target, respectively.

The latter is especially important in the bargaining which precedes inward investment. TRIMs offer a vehicle for altering the distribution of rents associated with investment incentives and/or protection. Benefits which are provided through one set of instruments are reclaimed, at least in part. The redistribution is less transparent than if the parties had simply negotiated on the incentive package — the transfers associated with a cash grant are more visible than those associated with a minimum export requirement. This probably suits both parties to the contract, however.

This conjunction of investment incentives and/or protection and TRIMs is crucially important. Where TRIMs are binding, they are explicitly investment disincentives in that they oblige investors to do something they would not otherwise have done. The reason they comply is that it gives them access to the benefits of investment incentives/protection. Compliance with the TRIMs simply means trading off some of these rents.

Viewed in this light, TRIMs are seen by host countries as instruments of investment policy rather than trade policy. However, looking at the list in Table 62, it is clear that some TRIMs have direct trade-distorting effects. Local content requirements, which have been extensively evaluated by Grossman (1981), Davidson et al. (1985), Richardson (1990) and Greenaway (1990) are cases in point. So too are minimum export requirements, trade balancing requirements and export controls. Thus, even if one accepts that they are measures designed to influence investment rather than trade, the fact remains that they have a direct impact on the latter. As such, there is at least a *prima facie* case for extending GATT disciplines to cover TRIMs. As we shall see later, arguably local context and minimum export requirements are outlined by Articles III and XI.

The second complication is that the interdependence between TRIMs and other interventions complicates the analysis of their welfare effects considerably. The evidence on incidence cited above suggests that TRIMs complement other instruments, particularly investment incentives and import protection. This makes it very difficult to comment on their welfare effects.

Following on from the above, there may be circumstances in which TRIMs appear to be relatively effective and efficient forms of intervention from the standpoint of the host country. Thus, Grossman (1981) has demonstrated that a content protection scheme can be a more effective means of supporting input suppliers than an equivalent tariff, and Richardson (1990) has extended this to argue that it also may be more efficient. In the case of a minimum export requirement, Greenaway (1990) shows that although this may be a more efficient means of supporting an export-oriented industry than an outright export subsidy, in the absence of some pre-existing distortion it remains unambiguously welfare reducing. Rodrik (1987) has shown, however, that if the

export requirement is introduced alongside a pre-existing tariff it may be welfare improving.

Note that we are not arguing that the combination of import protection with a content requirement, or a minimum export requirement, is optimal. It is not. Eliminating import protection and not introducing the content requirement/export requirement would be the first best solution. The point is that in a second best situation where pre-existing interventions are regarded as constraints, the introduction of certain TRIMs can, possibly correctly, be viewed as welfare improving by the host government. However, they are second best policies, and can be 'beggar-thy-neighbour' policies.

5. Europe 1992, the single market and inward investment

A number of studies have pointed to a connection between economic integration and FDI (UNCTC, 1990; Greenaway, 1987; Shepley, 1991; Yannopolous, 1990). In each case the data appear to support a positive association, particularly in the case of the Community. This association is tied into the opportunities which integration offers to exploit firm-specific ownership advantages. The data also shows, as we saw earlier, that the Europe 1992 programme has given a stimulus to inward FDI. We should note too that it has also stimulated an upsurge in cross-border intra-Community FDI as European firms seek to exploit scale economies, diversify risk, gain access to distribution networks and ultimate consumers. Among other things the abolition of exchange controls, free rights of establishment and expected harmonization of the regulatory framework have helped. It is easy to see then how market completion can stimulate intra-Community cross-border investment — this after all is one of the principal objectives of the programme. What about non-EC firms — how might the 1992 programme be expected to impact upon them?

In Section 2 we examined the interaction of ownership, locational and internalization advantages in explaining FDI. When all of the 1992 Directives are implemented the nature of the European market will alter fundamentally. The abolition of customs controls, harmonization of standards, elimination of national restraints, harmonization of policy and so on offer the lure of a market of some 340 million consumers. This is almost as large as the USA and Japan combined. The potential scale benefits of this have rightly been emphasized, as has the potential for real income growth. Together these enhance the locational advantages of the Community and raise the rate of return to ownership assets both in the short and long run. In turn this stimulates opportunities for bridgehead investment and/or rationalization investment and/or export-oriented investment.

Bridgehead investment refers to new investment in a specific location which is regarded as a base to gain a presence in, and potentially service the wider European market. The potential locational advantages of the Community, and individual Member States after 1992 are summarized in Table 59. These relate to inputs, scale economies, government policy and infrastructure. Where the advantages are EC-based, it is not obvious that a specific location within the Community will be chosen as the bridgehead. Choice of location will then be fashioned by country-specific factors such as the price and/or quality of inputs, or the availability of particular investment incentives. Take the example of Japanese investment in the United Kingdom. The United Kingdom has some locational advantages, most notably relatively low labour costs and a language which is attractive to Japanese investors. There is some survey-based evidence to indicate that using the United Kingdom as a bridgehead has been an important factor in the decision to locate, especially in the consumer and electronics industries and in car manufacture where minimum efficient scale of production is large relative to the total Community market (see Dunning, 1988; Jetro, 1990). The 1992 programme reinforces these locational factors. This, of course, is a particular form of export-oriented investment in so far as the subsidiary intends to serve markets outside of the host. With the creation of a European Economic Area, the likelihood of Community enlargement (with applications from Sweden and Austria pending and others ready to follow) and the opening-up of Eastern Europe, the Community will become an increasingly attractive location for exporting to the wider pan-European market.

The foregoing pertains to the market access strategies of new entrants. It is also likely that incumbents will undertake additional investment in response to Europe 1992 measures, in part too for the reasons outlined above, but also as rationalization investment. Market completion may necessitate a restructuring of existing operations, for instance closing down some facilities and concentrating on others, or building additional plants to service the entire market rather than subsets of it. There are a number of sectors where NTBs have resulted in market segmentation and frustrated rationalization. Good examples are pharmaceuticals, telecommunications equipment and electrical power equipment. By contrast significant horizontal and/or vertical specialization has occurred in motor vehicles, microelectronics, television receivers and agricultural machinery. Experience in these sectors offers an indication of the scope for rationalization which may exist in other areas.

There is nothing in the 1992 programme which is protectionist *vis-à-vis* outside countries. However, a potential for market closure or restricted market access has been widely discussed. Potential threats to arm's-length exports are perceived in Japan and North America via: the rationalization of national source-specific restraints; aggressive reciprocity especially in financial services; discriminatory government procurement; standard setting in consumer electronics and high-tech activities and so on. The potential for restraints on the activities of MNEs through local content and rules of origin provisions has also been commented upon. These are added together by some commentators in portraying the so-called 'fortress Europe' scenario. Notwithstanding the recent auto-arrangement, these fears are exaggerated. Nevertheless, it would be foolish to deny that they have led to some fortress jumping investment. Survey evidence identifies this as an important consideration. Kume and Tutsuka (1990), for example, provide evidence linking FDI to rules of origin, VERs and anti-dumping actions. The probability of impeded market access may be low, but some MNEs regard it as positive and have undertaken investment by way of insurance.

Thus, one can make a credible case to the effect that the locational characteristics and locational advantages of the Community are altered by the regime change accompanying the single market programme, as summarized in Graph 33. This offers a lure to overseas investors, and especially to Japanese investors with pronounced ownership advantages centring on organizational and managerial skills. In turn this is stimulating an increase in FDI in the Community, over and above what would have occurred in the absence of the single market programme. It may be recalled that in the late 1950s and the decade of the 1960s there was a surge of FDI from the USA into the member countries of the Community following its establishment. It is now well established in the literature that the increased flows of FDI into the Community was in response to the enlarged market opportunities and growth in incomes of the Community rather than tariff barriers to American exports. Preliminary statistical analysis of the determinants of Japanese FDI in the Community during the period 1975-88 also suggests that enlarged market opportunities in the Community appears to be a much more powerful stimulant than potential barriers to trade.

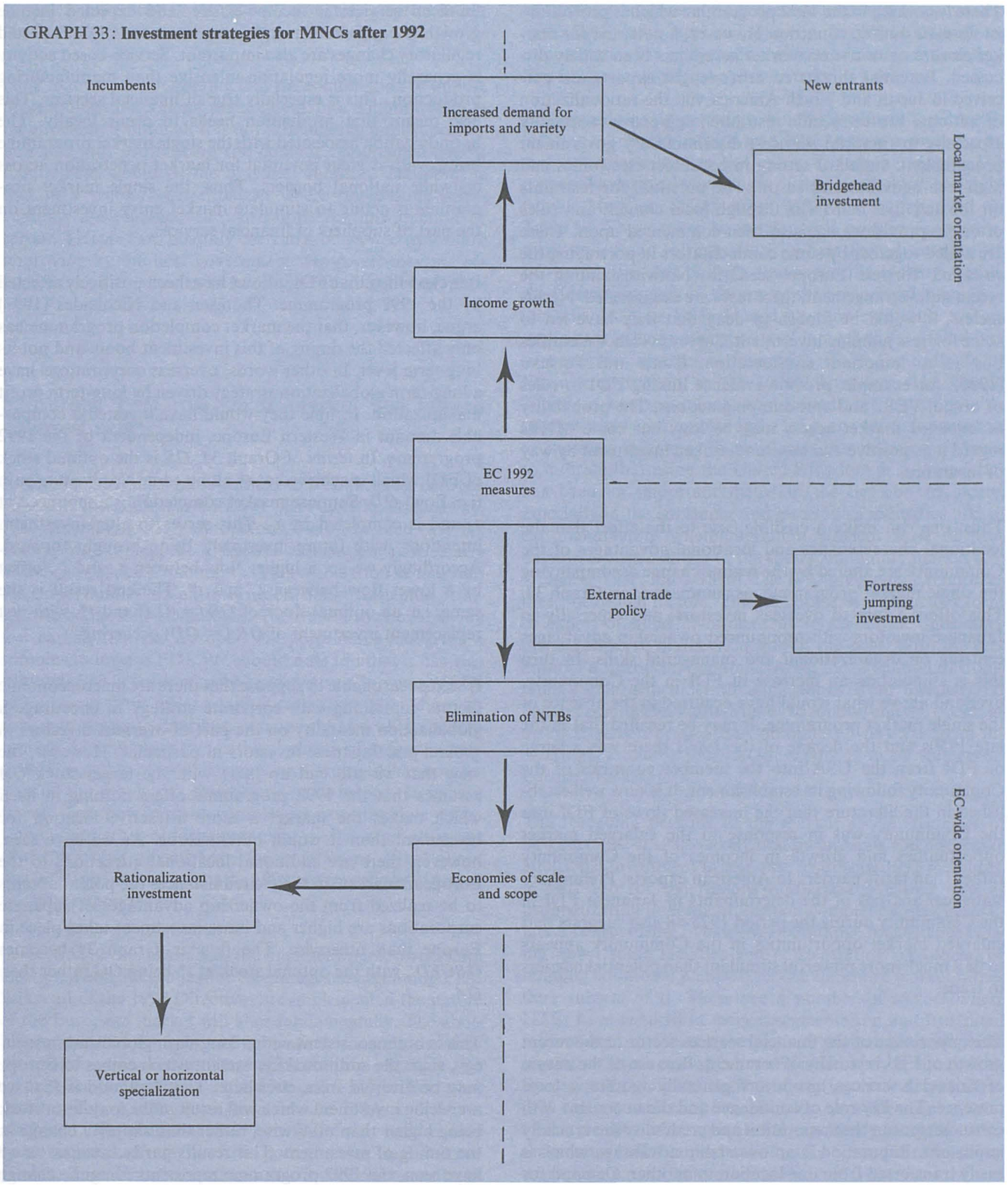
The importance of the financial services sector to the recent growth of FDI is worthy of comment. Because of the nature of financial services, producers generally require a local presence. The key role of confidence and direct contact with consumers mean that reputation and credibility are crucially important. Reputation is an ownership advantage which is easily transferred from one location to another. Demand for financial services is income-elastic, and expected income growth is one factor in explaining increased FDI. Expected regulatory changes are also important. Service-based activity is generally more regulation-intensive than manufacturing production. This is especially true of financial services. This also means that production needs to occur locally. The harmonization associated with the single market programme brings with it great potential for market penetration across erstwhile national borders. Thus, the single market programme is acting to stimulate market entry investment on the part of suppliers of financial services.

It is clear then that FDI inflows have been positively affected by the 1992 programme. Thomsen and Nicolaides (1991) argue, however, that the market completion programme has only affected the timing of this investment boom and not its long-term level. In other words, overseas corporations have a long-term globalization strategy driven by long-term profit maximization. In time they would have invested a comparable amount in Western Europe, independent of the 1992 programme. In terms of Graph 34, OS is the optimal stock of FDI which is achieved at t^* along some steady state path (i.e. flow) OD. Suppose market completion is announced at t_1 and is completed by t_2. This serves to alter investment intentions, with future investment being brought forward. Accordingly we get a higher flow between t_1 and t_2, offset by a lower flow between t_3 and t^*. The end result is the same, i.e. an optimal stock of OS ($= OA$) and t^*, with just replacement investment of OR ($= OD$) occurring.

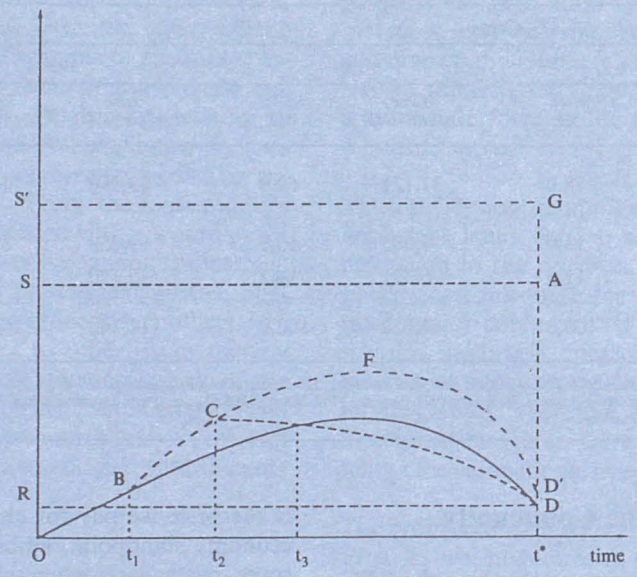
It seems reasonable to suppose that there are macroeconomic factors combining with corporate strategy to encourage a globalization mentality on the part of overseas investors in general and Japanese investors in particular. However, the view that we still end up in t^* with the target stock OA assumes that the 1992 programme offers nothing in itself which makes the market a more attractive location for investment than it would otherwise be. As we have seen, however, there are additional locational attractions to the European market. In these circumstances the potential rents to be realized from the ownership advantages of Japanese corporations are higher and more investment takes place in Europe than otherwise. The flow in Graph 34 becomes $OBCFD'$, with the optimal stock at t^* being OG rather than OA.

This is not inconsistent with a long-term globalization strategy, since the additional investment which comes to Europe may be diverted from elsewhere. The likelihood is that we are seeing investment which will result in the long-term stock being higher than otherwise, rather than simply a change in the timing of investment. This results partly because, as we have seen, the 1992 programme represents a regime change

GRAPH 33: **Investment strategies for MNCs after 1992**



GRAPH 34: **Japanese FDI in Europe**



offering additional locational advantages to the Community; partly because the programme will enhance the longer term growth prospects of the European market. Moreover, as Japanese MNEs mature the extent of their involvement in local production rather than exporting will increase. As Table 64 shows there is a marked difference between US and Japanese MNEs in their relative dependence on exports and local production in the Community. This is partly a reflection of market conditions in the 1960s and 1970s when the two waves occurred. However, it is largely due to the position of Japanese MNEs in the investment-product cycle. As Dunning and Cantwell argue, '... as Japanese companies become more internationalized it is reasonable to assume they will gain from the economies of expansion, scope and geographical diversification as have their European and US predecessors.' (p. 176).

In this section we have focused primarily on Japanese inward investment. A combination of pull and push factors makes Japanese MNEs the key marginal suppliers of FDI. As we have seen, there are important pull factors associated with the 1992 programme. The obvious push factors are the dramatic Japanese current account surplus, and the associated appreciation of the yen. It is, however, important to note that other sources of inward FDI will also be important in the 1990s. 'Traditional' sources like the USA and EFTA, especially the latter given the EEA agreement signed in May 1992, will be significant. So too, however, will some of the NIEs. A number of the larger corporations in Korea and Taiwan are beginning to become footloose. A dynamic European market in the 1990s offers obvious attractions, not the least of which is faster growth, which is correlated with the growth of FDI.

Table 64

The structure of Japanese and US involvement in EC manufacturing, 1976-86

	Japan				USA			
	1976		1986		1976		1986	
	Value (million USD)	Share (%)	Value (million USD)	Share (%)	Value (million USD)	Share (%)	Value (million USD)	Share (%)
Exports	8,635	78,0	31,121	69,9	13,190	11,2	41,779	16,3
International production	1,213	11,0	7,085	15,9	99,033	84,4	201,237	78,5
Non-affiliate licensing	1,218	11,0	6,321	14,2	5,120	4,4	13,360	5,2
Total	11,066	100,0	44,527	100,0	117,343	100,0	256,376	100,0

Source: Eurostat: (1986) *Industry statistical yearbook*, (1987) *External trade statistical yearbook;* US Department of Commerce, *US direct investment abroad, 1982 benchmark survey data*, and *US direct investment abroad* (1977), *Survey of Current Business*, February 1977, January 1980, March 1988, August 1988; Japanese Ministry of Finance (1982, 1987) *Zaisei Kinyu togei Geppo;* IMF (1988) *Balance of payments statistics yearbook*.

6. Policy coordination in the Community

Chapter Four (Title II) of the Treaty establishing the EEC provides for the implementation of a common commercial policy, whose main element is represented by the common external tariff. Variations in the level of the tariff, exceptions to it, and trade agreements with third countries are negotiated at the Community level, rather than by individual Member States. In recent years, however, this common policy has been eroded to some degree by national measures — most notably source-specific restraints such as voluntary restraint arrangements (VRAs) and State aids. Together with a wide range of other non-tariff measures these have served to fragment the European market in some sectors (e.g. automobiles, textiles and clothing). The 1992 programme will of course sweep these away. Harmonization of a range of policies, together with the abolition of Article 115 provisions will result in a truly common commercial policy. This reduces the scope for independent action of the part of individual Member States.

In the past measures like VRAs have proved attractive as a palliative to adjustment problems. Once that degree of freedom is foreclosed, there is a possibility that investment policy could be more actively deployed to influence industrial location. The extent to which this occurs will be fashioned by adjustment pressures on the one hand, and the degree to which State aid and regional support policies are harmonized on the other hand. The Cecchini Report and other analyses have forecast adjustment pressures in the form of transitional unemployment. From an economic standpoint, this is neither a surprise, nor necessarily a problem. After all, adjustment is the price we pay for change. However, from a political economy standpoint, adjustment pressures can be troublesome, particularly when they are non-randomly distributed. It is not easy to forecast exactly which sectors/regions will be most affected. Two points can, however, be made. First, some recent research suggests that the marked increase in intra-industry specialization may have recently tailed off, and possibly even reversed (Greenaway and Hine, 1991). The importance of this is that both a priori theorizing and some empirical evidence suggest that adjustment to trade expansion may be smoother in a setting of intra- as opposed to inter-industry expansion. The second point to note is that the Community already has a 'regional problem' in that a number of areas, largely on the periphery, are relatively underdeveloped, have relatively low incomes per head, and relatively high unemployment. These sectors could be more exposed in the adjustment to market completion.

For these reasons governments could come under pressure to provide adjustment assistance of some form. As already noted, source-specific restraints have proved popular in the past; some alternative like State aid could prove popular in the future. A recent Commission study has drawn attention to the level and distribution of State aid in the Community. Between 1986 and 1988, an average of 2,2% of GDP (or 4,5% of total government expenditure) was disbursed as State aid by Member States.[1] This amounts to more than twice the Community budget. Moreover, there is a large

[1] This figure includes public transfers to the following sectors: agriculture, fisheries, transport and coal.

variance around this figure from 1,0% of GDP in Denmark to 4,1% in Luxembourg. Additional data on State aid to manufacturing are provided in Table 65. Already therefore there exists quite a wide disparity in the practices of Member States. In adjusting to the completed market, and beyond that in preparation for the single currency, there will be obvious pressures on providing State aids to encourage investment. Where this is coordinated and provided under one of the exemption Articles of the Treaty (e.g. relating to regional aid), it is not a problem. Where, however, it is selective, and used to confer advantages on particular enterprises, it clearly is a problem. From the Community's standpoint there are dangers associated with uncoordinated action. First, some of the benefits of a common commercial policy could be eroded if Member States make greater independent use of investment incentives. Second, conflicts over investment policy could spill over to other issues thereby threatening consensus. Third, from the standpoint of the Community as a whole, competition between Member States to attract inward investment redistributes some of potential gains from FDI away from the host country, and towards the investing corporation.

Table 65

State aid to manufacturing — yearly averages, 1986-88

	Million ECU	Percentage GDP	Percentage GVA[1]	Percentage GFCF[1]	ECU per person employed[1]
B	1 054	0,9	4,3	19,0	1 437
DK	275	0,3	1,9	5,5[2]	519
D	7 639	0,8	2,7	15,7	963
GR	1 043	2,5	15,8	n.a.	n.a.
E	2 930	1,2	4,9	n.a.	1 207
F	5 664	0,7	3,7	17,5	1 253
IRL	408	1,6	6,1	35,0[3]	1 947
I	9 563	1,5	6,3	27,7[2]	1 900
L	34	0,7	2,5	10,5[2]	892
NL	1 070	0,6	3,2	10,6	1 182
P	462	1,4	5,3	28,4	568
UK	3 570	0,6	2,6	15,2	666
EUR 12	33 714	0,9	3,8	n.a.	1 147[4]

[1] Gross value-added, gross fixed capital formation and occupied population in manufacturing. Manufacturing GVA estimated for Ireland.
[2] 1986 only.
[3] Average of 1986 and 1987.
[4] Excluding Greece.

Source: European Economy No 48, Sept. 1991.

One has to take care not to overstate the potential dangers here. The evidence on intra-industry specialization is limited. Moreover, FDI appears to be related to intra-industry specialization — thus the increase in FDI which has occurred is likely to stimulate intra- as opposed to inter-industry specialization. Important efforts have been made at the Community level to avoid the undesirable consequences that uncontrolled State aid could have for the internal market and trade among Member States. We should also note that progress has been made on consensus building and recent measures have been undertaken to improve transparency and enforce disciplines (e.g. the repayment of illegal subsidies). In addition, the Commission has attempted to bring in a systematic force in the form of increased resources for regional support.

Thus, policy coordination across Member States may be an important issue. So too might policy compatibility. The discussion in the previous section implied that alternative policies can substitute for each other. The basic theory of trade policy confirms that this is so. Recent research has revealed important interconnections between trade policy, investment policy, competition policy and regulation in the services sector. Therefore, in addition to harmonization of investment measures, there is also an issue of the compatibility of investment measures and other measures.

The problem of policy compatibility arises for three reasons. First, as we have already stressed, increasing openness of economies means that investment policy can no longer be thought of simply as a non-border measure. Many instruments of investment policy have trade effects. Second, and related to the foregoing, different instruments of policy can have equivalent effects. Third, investment policy might have multiple objectives — both macroeconomic and microeconomic. This potentially gives rise to two problems — feedback between policy instruments, and porosity across instruments.

Feedback can be positive or negative, reinforcing or counteracting the effects of other policies. An example of positive feedback is where tax allowances encourage investment in a particular region, where other government policies like location of central services are in place. An example of negative feedback would be where State aid to encourage investment in a particular sector run counter to the objectives of competition policy. Clearly in the latter case policy conflict arises. Not only can this lead to conflict between agencies it can also stimulate further feedback effects. From the Community's standpoint it is not a trivial issue. Macroeconomic policy coordination is high on the political agenda, as it is seen as central to securing the full benefits of the single market, and moving the Community closer to a single currency. Microeconomic policy coordination across policies is also necessary if the full benefits of a single market are to be realized.

This is related to the problem of porosity. Because different policy instruments can have equivalent effects, regulation in one area can lead to increased use of unregulated instru-

ments. If, for example, investment grants are tightly regulated, more flexible arrangements on reporting, or tax incentives, could be offered to attract a MNE. This is important both from a regional and multilateral standpoint. If there are perceived to be net benefits from FDI, and if governments compete to secure such investment, the by-product distortions of intervention are minimized with compatible policies. Again, one must take care not to exaggerate this. The whole point of harmonization is to reduce the potential for porosity.

There is also a global dimension to this. One of the major priorities for the Uruguay Round negotiations is to ensure that agreements on TRIMs, subsidies, services and IPRs are compatible. Beyond Uruguay, a key issue for any world trade organization is the compatibility of regulation in these areas with competition policy. These are issues we return to in the next section.

7. Multilateral rules on investment

From the data provided in Section 2, and subsequent discussion, two points stand out. First, MNEs are key actors, and increasingly so, in the process of international specialization and exchange. Second, a wide range of policy instruments are available to influence the locational decisions of MNEs. By definition MNEs are internationally mobile. Their ability to arbitrage regulatory regimes or support measures can be a source of both policy competition and policy conflict. The growing influence of MNEs has resulted in a great deal of international negotiation and cooperation to set standards regarding the treatment which they face in host countries and, to a lesser extent, to regulate their behaviour. The output of international negotiations has varied somewhat depending upon the nature of the agreement and its coverage: from legal instruments through codes of conduct to understandings; and agreements/arrangements which can be bilateral, regional or multilateral.

As noted in Section 3, investment policy has historically been regarded by host governments as a non-border instrument. This being so, it is hardly surprising that bilateral treaties should have proliferated, with close to 300 in existence. Their function is largely as a signalling mechanism — host governments commit to certain standards of treatment relating to nationalization, compensation, most favoured nation treatment, dispute settlement and so on. As such they can offer insurance of sorts to inward investors. As with bilateral trading arrangements, however, the resulting patchwork is a less efficient, less transparent solution than a multilateral regime.

As Table 66 shows, there have been a large number of regional and multilateral agreements relating to MNEs since the early 1960s, especially regional arrangements. The titles of the various treaties, conventions and codes give an indication of their coverage. Mostly they are directed at setting standards relating to *inter alia:* treatment of investors; investment climate; entry conditions; ownership; conditions of employment; transfer of technology; consumer protection; jurisdiction; dispute settlement. The most active multilateral forum has been the OECD, followed by the World Bank. Since, however, GATT is now involved in the issue, it could become the lead institution. Although there are a myriad of agreements/arrangements there appears to be some convergence of practice, and this has laid the foundation for the draft UN Code of Conduct on Transnational Corporations.

In so far as MNEs arbitrage regulatory regimes, and this can distort investment flows, some kind of multilateral arrangements are clearly in order. MNEs can also arbitrage policy regimes, however. Thus, we need to enquire into the status of informational agreements governing the use of investment incentives both by home and host governments. The principal instrument of the former is export credits; whilst as we have seen, many host governments are known to have recourse to a range of incentives and TRIMs.

TRIMs were explicitly included as an agenda item on the Uruguay Round. Developing countries in particular have resisted multilateral disciplines on the grounds that many TRIMs do not have direct trade-distorting effects, and even those that do are investment measures rather than border measures. The submissions of most industrialized countries are equally adamant that some TRIMs (most notably local content and minimum export requirements) have trade-distorting effects, and their use needs to be disciplined. At the time of writing, a draft text including the principle of a waiver for developing and least developed countries, on a time-constrained basis, has been informally agreed. Since local content requirements have been found by a GATT panel to be contrary to Article III in at least one important case (against the Canadian Foreign Investment Review Agency (FIRA)), it is probable that greater discipline can be brought to bear on TRIMs through existing mechanisms. This together with the (surprising) degree of consensus on the part of industrialized countries regarding the principle of disciplining trade-distorting TRIMs make an eventual agreement likely.

Investment incentives are also a fairly heterogeneous mix of instruments. The most commonly used are some form of direct subsidy typically operating through a cash grant, accelerated depreciation or development subvention. Several GATT Articles pertain to subsidies — VI, XVI and XXIII.

Table 66

Main international arrangements relating to transnational corporations

Title	Date of adoption	Organization	M/R[1]	Legal form	Status
A — Comprehensive instruments					
Draft UN code of conduct on transnational corporations		United Nations	M	To be decided	Under negotiation
Declaration on international investment and multinational enterprises	21 June 1976	OECD	R	Recommendation and decision of the Council	Adopted
Andean foreign investment code: Common regime of treatment of foreign capital and trade marks, patents, licences and royalties (Decision 220)	12 May 1987	The Cartagena Agreement (Andean Pact)	R	Decision of the Commission	Adopted
B — Instruments dealing with particular issues					
Code of liberalization of capital movements	19 December 1961	OECD	R	Decision of the Council	Adopted
Code of liberalization of current invisible operations	13 December 1961	OECD	R	Decision of the Council	Adopted
Convention on the settlement of investment disputes between States and nationals of other States	18 March 1965	World Bank	M	Convention	Adopted In force
Convention establishing the inter-Arab Investment Guarantee Corp. (IAIGC)	1970	Council for Arab Economic Unity (CAEU)	R	Convention	Adopted
Convention on a code of conduct for Liner Conferences	6 April 1974	Unctad	M	International Convention	Adopted In force
European Convention on product liability with regard to personal injury and death	27 January 1977	Council of Europe	R	Convention	Adopted In force
Model convention for the avoidance of double taxation in respect of taxes on income and on capital	11 April 1977	OECD	R	Recommendation of the Council	Adopted
Recommendation concerning the safety of consumer products	18 December 1979	OECD	R	Recommendation of the Council	Adopted
Guidelines on the protection of privacy and transborder flows of personal data	23 September 1980	OECD	R	Recommendation of the Council	Adopted
The set of multilaterally agreed equitable principles and rules for the control of restrictive business practices	5 December 1980	Unctad	M	General Assembly Resolution 35.63	Adopted
International code on the marketing of breast milk substitutes	21 May 1981	WHO	M	Resolution of the World Health Assembly (34.22)	Adopted
Principles concerning transfrontier movements of hazardous wastes	1 February 1984	OECD	R	Recommendation and decision of the Council	Adopted
First, Second and Third ACP-EEC Conventions of Lomé	28 February 1975 31 October 1979 8 December 1984	ACP/EC Governments	R	Conventions	Adopted In force
United Nations guidelines for consumer protection	9 April 1985	UN	M	General Assembly Resolution 39.248	

[1] Multilateral/regional.

Table 66 — *contd.*

Title	Date of adoption	Organization	M/R[1]	Legal form	Status
Declaration on transborder data flows	11 April 1985	OECD	R	Declaration	Adopted
Convention establishing the Multilateral Investment Guarantee Agency (MIGA)	11 October 1985	World Bank	M	Convention	Adopted Not in force
International code of conduct on the distribution and use of pesticides	28 November 1985	FAO	M	Resolution of the FAO Conference	Adopted
Revised code of conduct for companies from the EC with subsidiaries, branches or representatives in South Africa	19 November 1985	Ministers for Foreign Affairs of EC States	R	Recommendation	Adopted
Draft UN code of conduct on the transfer of technology		Unctad	M	To be decided	Under negotiation
Draft international agreement on illicit payments		United Nations	M		Not adopted

[1] Multilateral/regional.

The first sanctions recourse to countervailing duties (CVDs), if material injury can be associated with a subsidy. Article XVI places an obligation on contracting parties to notify any trade relevant subsidies, whilst XXIII sanctions retaliation if rights under XVI are impaired or nullified. The Code on Subsidies agreed in the Tokyo Round supplements and clarifies these obligations but has not worked well. Thus, subsidies too are an agenda item on the Uruguay Round. Some convergence has occurred on the part of contracting parties around the so-called traffic light approach. This states that some State aid be prohibited (e.g. export subsidies); some be permitted (e.g. non-discriminatory measures like provision for infrastructure); and some be actionable where material injury can be established. The sticking point to an agreement here relates not to the traffic light principle but to the components of the various categories. As with TRIMs if an agreement is reached, it should bring greater discipline to the use of investment incentives.

The final issue we should address on multilateral issues is to consider how disciplines could evolve under the auspices of GATT. This is not to assert that the GATT is the only forum in which agreement could be reached — as we have seen, both the UN and the OECD have been active in this respect. If, however, significant progress is to be made, the GATT is the key institution. The OECD is essentially seen as a Northern club by developing countries and the UN is not in a position to nest any codes in the wider framework of trade rules. The latter is especially important since investment rules are part of a much bigger picture. As borders shift back with increasing openness, and the role of conventional trade instruments, most notably tariffs, declines, issues that were formerly regarded as non-border measures — investment policies, regulation of services, protection of intellectual property, competition policy — are increasingly becoming the subject of trade friction. The inclusion of services, intellectual property rights (IPRs) and TRIMs on the Uruguay Round agenda is an acknowledgement of this imperative. Circumstances in the world economy and world-trading system have changed profoundly since the GATT's inception; and the need for a more rules-based system which can accommodate investment, as well as other issues, is paramount.

This, of course, begs the question of exactly how investment can be accommodated under GATT disciplines. This is an issue recently addressed by Greenaway and Sapir (1992) in an assessment of progress on all the new issues, i.e. services and IPRs as well as investment. It was argued there that GATT disciplines as they apply to merchandise could not be transposed to the new issues — complete harmonization is not necessarily desirable, let alone feasible. This is so because differences in regulatory regimes arise for historical reasons, and it is not always clear that one regulatory regime is necessarily more efficient than another. Efforts at complete harmonization would quickly run up against the buffer of national sovereignty. However, the principles on which GATT disciplines are based can be extended to the new issues in general, and investment in particular. Specifically, national treatment, mutual recognition and most favoured nation are all transferable. In the case of investment the first two are especially important. For the Uruguay Round this means identifying those TRIMs which have significant trade-distorting effects and affirming the applicability of appropriate GATT articles. Thus, in the case of local content requirements, Article III is clearly germane. As argued above,

however, TRIMs are only part of the picture and, in the longer term a code covering direct investment is required, embracing rights of establishment, home and host country obligations and dispute settlement mechanisms. It is notable that in the European Community where a great deal of convergence has already taken place and where Member States have a long history of cooperation, progress is being made on the basis of directives which affirm national treatment and mutual recognition, rather than attempts to secure harmonization. That experience offers a valuable guidepost to the wider trading community.

8. Conclusions

FDI has a long history as a market access strategy. Over the last decade its importance has increased dramatically, due largely to the interaction of a number of globalization forces — the continued growth of international trade; increasing liberalization and openness of national markets; integration of capital markets; innovations in managerial structures. The European Community is at the forefront of these developments, as the major host to and source of FDI globally. The Community's single market programme has increased its attractiveness as an investment location, especially to Japanese corporations which are the key marginal suppliers of FDI. The 1992 programme has also stimulated an upsurge in intra-Community cross-border investment, as restructuring efforts prepare European firms for the single market.

The continued decline of 'traditional' border measures like tariffs, combined with increasing openness, will place investment measures at the forefront in the 1990s. Governments have at their disposal a wide array of instruments which can be deployed in an attempt to influence the location, level or composition as well as the distribution of gains, from investment. Notwithstanding a large number of codes and arrangements/agreements multilateral disciplines on investment measures are weak. In the absence of further multilateral measures, there will be pressures for regional and/or bilateral agreements. As with merchandise trade this would be second-best to multilateral disciplines which encompass all GATT signatories. Multilateral disciplines will maximize the potential net benefits of cross-border investment, and minimize the likelihood of investment tensions replacing trade tensions as a source of policy competition. Since the process of integration is further advanced in the Community than elsewhere, more progress has been made in affirming national treatment and mutual recognition as key principles governing cross-border investment. The wider international community could usefully learn from this in framing the more rules-based regime which will be necessary to incorporate investment, services, intellectual property protection and competition policy into the GATT framework.

References

Baldwin, R. (1989) The growth effects of 1992, *Economic policy,* No 9, pp. 243-270.

Balasubramanyam, V. N. (1988) 'The case for TRIMs', mimeo, Lancaster University.

Cantwell, J. (1982) 'International production and international trade' in Greenaway, D. and Winters, L. A. (eds), *Surveys in international trade,* Blackwells, Oxford.

Davidson, C., Matsutz, S. and Kreinin, M. (1985) 'Analysis of performance standards for direct foreign investment', *Canadian Journal of Economics,* Vol. 18.

Dowrick, S. (1992) 'Technological catch-up and diverging incomes: paths of economic growth 1960−88', *Economic Journal,* Vol. 102, pp. 600-10.

Dunning, J. (1981) *International production and the multinational enterprise,* Allen & Unwin, London.

Dunning, J. (1988) *Explaining international production,* Unwin Hyman, London.

Dunning, J. and Cantwell, J. (1991) *Japanese direct investment in Europe.*

Eurostat. (1992) *European Community direct investment 1984-89,* Eurostat, Luxembourg.

Graham, E. and Krugman, P. R. (1991) 'Foreign direct investment in the United States', Institute for International Economics, Washington, DC.

Greenaway, D. (1987) 'Intra-industry trade, intra-firm trade and European integration', *Journal of Common Market Studies,* Vol. 26, pp. 153-172.

Greenaway, D. (1990) 'Trade-related investment measures: political economy aspects and issues for GATT', *The World Economy,* Vol. 13, pp. 367-386.

Greenaway, D. and Sapir, A. (1992) 'New issues in the Uruguay Round: services, TRIMs and TRIPs', *European Economic Review,* Vol. 36, pp. 153-172.

Greenaway, D. and Hine, R. C. (1991) 'Intra-industrial specialization, trade expansion and adjustment in the European economic space', *Journal of Common Market Studies,* Vol. 25, pp. 603-22.

Grossman, G. (1981) 'The theory of domestic content protection and content preference', *Quarterly Journal of Economics,* Vol. 96, pp. 591-607.

Jetro. (1990) 'Current situation of business operations of Japanese manufacturing enterprises in Europe', Sixth Survey Report, Jetro, London.

Kreinin, M. (1988) 'How closed is the Japanese market?', *The World Economy,* Vol. 11, pp. 529-542.

Kume, G. and Totsuka, K. (1990) 'Japanese manufacturing in the European Community: motivations and locations', mimeo, Sumitsono Research Institute.

Lipsey, R. (1991) 'Foreign direct investment in the US and US trade', Working Paper No 3623, National Bureau of Economic Research, Cambridge, MA.

Richardson, M. (1990) 'Content protection', mimeo, Georgetown University.

Rodrick, D. (1987) 'The economics of export performance requirements', *Quarterly Journal of Economics,* Vol. 102, pp. 633-650.

Scott, M. (1992) 'A new view of economic growth', *Economic Journal,* Vol. 102, pp. 622-632.

Shaw, G. K. (1992) 'Policy implications of endogenous growth theory', *Economic Journal,* Vol. 102, pp. 611-621.

Shepley, S. (1991) 'FDI in the context of European economic integration', mimeo, European Commission, Brussels.

Thomsen, S. and Nicolaides, P. (1991) *The evolution of Japanese direct investment in Europe,* Harvester Wheatsheaf, London.

UNCTC. (1990) 'Regional economic integration and the transnational corporations in the 1990s', United Nations, New York.

UNCTC. (1988) 'Transnational corporations in world development: trends and prospects, United Nations', New York.

Yannopolous, G. (1990) 'Foreign direct investment and European integration: the evidence from the formative years of the European Community', *Journal of Common Market Studies,* Vol. 27, pp. 235-259.

II — Services

Patrick A. Messerlin[1]
Institut d'études politiques de Paris

Summary

This paper provides evidence about the recent trend towards more global markets in services, surveys the economic arguments behind liberalization efforts, and examines the dynamic relationship between the single market programme in services (SMPS) of the European Community and the General Agreement on Trade in Services (GATS) in the coming years. It yields seven main results.

1. The shares of the major world trading countries for trade in services are similar to their shares for trade in goods (including the fact that developing countries successful in trade in goods are among the leading trading countries in services). However, the shares of foreign direct investment devoted to services, a crucial element for international competition in services, are not very different between the major world trading countries.

2. Evidence suggests an early, yet modest, impact of the SMPS on EC trade in services. The growth of intra-EC trade in services is faster than the growth of extra-EC trade, though the intra-EC share of EC total trade is lower in services than in goods. Intra-EC inflows of foreign direct investment have increased more than extra-EC inflows, though extra-EC mergers and acquisitions operations are more numerous than intra-EC operations.

3. Trade liberalization in services is a profitable policy. Comparative advantage is valid for services as well as for goods, despite the non-storability and intangible nature of services. Moreover, a 'dualistic' specialization pattern (with developed countries completely specialized in services and developing countries completely specialized in goods) is unlikely. Trade barriers are not the best solution to the complex problems of information or reputation related to the intangibility of services, particularly in the context of 'infant' service industries.

4. 'Offers' tabled at the Uruguay Round negotiations aimed at promoting trade liberalization lead to two observations: OECD countries' offers tend to cover more sectors than developing countries or NIEs, and the breakdown of the initial offers by sector presents a wide range of liberalization offers.

5. Trade liberalization would benefit from the implementation of a multilateral 'trade policy review' of the major policy instruments used by the countries for restricting trade in services. Such a review mechanism could rely on a taxonomy based on quantitative measures (quotas on domestic consumption, on imports and exports, and on inputs), on price instruments (tariffs, minimum or maximum prices), and measures aimed at creating a competitive environment (competition laws, laws specifying property rights) or an adequate level of information (prudential or disclosure rules).

6. There is a fundamental difference between the liberalization approaches of the SMPS and the GATS. According to the Treaty of Rome, the foundation of the SMPS, the single market goal requires the liberalization of both cross-border-based and establishment-based trade in services typically through the structure of 'mutual recognition' and 'minimal harmonization'. In contrast, the GATS defines four 'modes of supply' (cross-border trade, movement of service consumers, movement of service producers, and establishment of services providers in the foreign markets) and leaves open the possibility to liberalize only certain modes of supply, and thereby to limit the extent of trade liberalization. In particular, liberalization limited to establishment-based trade may lead to small gains. Competition in the service market concerned may not be greatly enhanced and it may be accompanied by adjustment costs high enough to discourage further steps of liberalization.

7. As a result, interactions between the SMPS and the GATS will be important for determining the real extent of trade liberalization in the coming years. It is argued that the SMPS is likely to be a driving force for exploiting the 'sleeping' opportunities of the GATS for three reasons. First, the SMPS conceives national regulations as dynamic instruments of competition, a heritage from the crucial 'Cassis de Dijon' ruling of the European Court of Justice. A constant search for optimal national regulations within the Community may spill over to the rest of the world through reciprocity or mimetism. In particular, mimetism is a channel through which the SMPS could influence the rest of the world, as illustrated by the SMPS acting as a source of inspiration for the reforms of US regulations on banking. Second, the whole SMPS exercise is based on a sophisticated enforcement of the competition rules of the Treaty of Rome, not only Articles 85 and 86, but also Article 90 (competition rules for public firms), 'exemptions' and 'block exemptions' from competition rules. Moreover, the SMPS is a multilateral effort to solve the difficult problem of 'sustaining' competition in services (deregulation of service industries may be followed by an increase in concentration, often after a period of decreased concentration). As a result, the SMPS may shift the GATS from a neutral attitude in terms of market structures (monopolies and 'exclusive service pro-

[1] I would like to thank A. Sapir, J. Scheele, B. Hoekman and the participants of the working group for very useful comments and suggestions.

viders' are recognized as legitimate market structures) to an attitude fully concerned with the possible impact of non-competitive market structures on market access. Lastly, the wide range of levels of economic development among EC Member States suggests that countries having wide differences between their regulatory framework can indeed engage in services liberalization without the need for 'special treatment', provided there are adequate measures for introducing progressive liberalization.

Introduction

Until the 1970s, international trade in services was ruled by a complex set of bilateral and sectoral agreements, with no widely endorsed multisectoral and multilateral agreements. The 1980s have witnessed two decisive efforts to integrate all services sectors into the kind of unified legal framework existing for international trade in goods: the free trade-oriented single market programme in services (hereafter SMPS), and the liberalization of service industries undertaken at the world level under the auspices of the General Agreement on Trade in Services (hereafter GATS) of the Uruguay Round.

The aim of this paper is twofold: first, to provide evidence about the recent trend toward more global markets in services and to examine economic arguments behind liberalization efforts (and the erosion of the factual and conceptual differences between services and goods which have been prevailing since World War I); second, to examine the dynamic relationships between the SMPS and the GATS which are likely to characterize the coming years. Examining services also requires covering forms of competition other than cross-border trade: the analysis will thus review foreign direct investment, labour mobility, and the establishment of firms in foreign markets in the area of services because, until now, these instruments have been frequent tools of international competition in services.

The paper is organized as follows. Section 1 documents trends in world trade in services, and focuses on the evolution of EC trade in services since the start of the SMPS (1986). Section 2 presents the main analytical issues raised by liberalization of trade in services in the Community as well as at world level. Section 3 provides an overview of the main types of barriers to trade in services and suggests a taxonomy of the major policy instruments used for regulating services industries. Section 4 outlines the fundamental differences between the SMPS and the GATS. Lastly, Section 5 examines the likely impact of the SMPS on the service industries of the rest of the world in the future.

1. International competition in services: major trends

In order to see whether there are early signs of the impact of the SMPS,[1] this section presents the increasing importance of trade in services in the world trade during the 1980s, with special emphasis on both extra-EC and intra-EC competition in services. The analysis on the Community is split into two time-periods, before and after the publication of the White Paper (1985). This exercise requires two caveats. First, as most of the 55 directives concerning all the major service industries which constitute the SMPS were introduced into Member States' laws in the late 1980s and early 1990s, the data here reveal more about the preparations to the SMPS than its direct impact. Second, it is well known that data on international competition in services have not reached the same level of detail and quality as data on trade in goods. In particular, a substantial risk of error flows from the growing interest in services, which has generated increasing efforts to produce more exhaustive data, potentially leading to inflated annual rates of growth (Hoekman, 1990).[2]

1.1. Trends in world competition in services

Table 67 presents an overview of world competition in services at the level of cross-border trade and establishment. Cross-border trade is illustrated by leading exporters and importers which represent more than 1% of world exports or imports of private services.[3] It leads to two observations. First, the structure of trade in services by countries is not very different from the pattern for trade in goods: the shares of the USA, Japan, intra- and extra-EC trade in world trade are not very far from their levels in trade in goods; and those developing countries which are successful in manufacturing are among the leading trading partners in services. Second,

1 Until 1985, unilateral liberalizations undertaken by a few EC Member States were not accompanied by EC measures, except for a first generation of EC Directives in insurance adopted in the 1970s which aimed at facilitating the freedom of establishment, but failed to do so.

2 The use of averages for the pre- and post-1986 periods reduces but does not eliminate this risk. Most of the data used in this section are based on Eurostat estimates which rely on balance-of-payments statistics. Such statistics have many shortcomings: they can be based on net flows (telecommunications) or gross flows representing transactions larger than the value of the services (insurance, trading), or they do not cover all transactions (banking). For details on the methodology used to address these problems, see Eurostat (1991).

3 Private services include travel, transport, non-merchandise insurance, communications, advertising, brokerage and management services, leasing, trading, and other professional and technical services.

Table 67

Leading traders and FDI host economies in services

Countries	Private services (1987)				Foreign direct investment		
	Exports		Imports		Total FDI (c)	FDI in services (d)	Year
	(a)	(b)	(a)	(b)			
				European Community			
Belgium and Luxembourg	19	3,8	17	3,3	6,6	17,3	1981
Denmark	8	1,6	7	1,4			
France	53	10,5	43	8,3	2,7	63,3	1985
Germany	41	8,1	65	12,6	6,5	46,1	1985
Italy	33	6,5	26	5,0	3,9	37,0	1985
Netherlands	23	4,6	23	4,5	16,2	42,7	1984
Spain	22	4,4	8	1,6	4,4	30,9	1984
United Kingdom	43	8,5	33	6,4	11,9	34,5	1984
				EFTA countries			
Austria	15	3,0	9	1,7	4,4	44,6	1981
Finland			5	1,0	1,3	41,3	1986
Norway	8	1,6	10	1,9			
Sweden	9	1,8	10	1,9			
Switzerland	14	2,8	12	2,3			
				Other countries			
Australia	5	1,0	8	1,6	10,5	47,0	1983
Canada	11	2,2	16	3,1	18,4	28,9	1984
Hong Kong	7	1,4	5	1,0	89,0	63,2	1981
Japan	28	5,6	52	10,1	0,4	28,6	1986
Korea	8	1,6	5	1,0	2,1	31,8	1986
Mexico	7	1,4	5	1,0	5,6	23,7	1981
Saudi Arabia			9	1,7			
Singapore	7	1,4	5	1,0	63,5	51,2	1981
South Africa			5	1,0			
Taiwan			6	1,2	8,3	23,7	1986
Thailand	4	0,8			5,4	45,0	1985
USA	56	11,1	56	10,9	5,0	53,1	1986
Yugoslavia			5	1,0			
					(f)	(f)	
World	504	100,0	516	100,0			
Countries (e)	421	83,5	445	86,2	14,0	39,7	—
EC countries	242	48,0	222	43,0	7,5	38,8	—
EFTA countries	46	9,1	46	8,9	2,8	42,9	—

(a) Values, in 1987 billion USD.
(b) Shares as a percentage of world trade in private services.
(c) Inward stock of total FDI, as a percentage of the GDP of the year mentioned.
(d) FDI in services as a percentage of total inward stock of FDI.
(e) All countries (with available data) listed.
(f) Unweighted averages.

Sources: Hoekman (1990); UNCTC (1988).

net trade flows in services show a mirror image in terms of net trade flows in goods — a manifestation of the trade balance constraint: net exporters of goods (Germany, Japan) tend to be net importers of private services, and vice versa (France, United Kingdom, and USA).

Factor movements and establishment of subsidiaries in foreign markets are essential tools of international competition in services. Table 67 provides the total inward stock of foreign direct investment for selected leading trading partners (as a percentage of GDP) and the share of this FDI devoted to service industries. On average, the Community is not very different from the rest of the world (excluding the special cases of Hong Kong and Singapore), though the variance between EC Member States is lower than that observed between the countries in the rest of the world, and despite the fact that two EC Member States (France and Italy) appear less open than the rest of the Community (and most industrial countries).

1.2. EC cross-border trade in services

EC cross-border trade in services is examined by trading partners (Table 68) and by sectors (Table 69). Tables 70 to 72 refine these overviews by giving a breakdown by Member State. Table 73 aims at providing some information on other major forms of international competition in services, e.g. establishment through mergers, acquisitions, and foreign direct investment. All these tables seek to test whether there has been an early impact of the SMPS, through an increase in intra-EC competition (trade or establishment), and by an acceleration of extra-EC competition.

Table 68, which presents a breakdown of cross-border trade flows in services by class of trading partner, yields three results. First, the intra-EC share of the EC total (intra- and extra-) trade is lower in services than in goods. Second, the growth of the intra-EC trade in services between the two periods is faster than the growth of extra-EC trade in ser-

Table 68

Geographical breakdown of cross-border trade in services and merchandise of the Community (1980-89)

	Credits				Rate of growth	Debits				Rate of growth
	Average 1980-85		Average 1986-89			Average 1980-85		Average 1986-89		
	Mio ECU	%	Mio ECU	%		Mio ECU	%	Mio ECU	%	
					Services					
World	171 557	100,0	222 412	100,0	29,6	153 033	100,0	206 577	100,0	35,0
Intra-EC	70 737	41,2	98 766	44,4	39,6	68 688	44,9	100 627	48,7	46,5
Extra-EC	100 821	58,8	123 647	55,6	22,6	84 345	55,1	105 950	51,3	25,6
Class 1 countries	58 497	34,1	80 323	36,1	37,3	52 981	34,6	69 563	33,7	31,3
USA	29 918	17,4	38 138	17,1	27,5	25 408	16,6	32 332	15,7	27,3
Japan	3 852	2,2	6 399	2,9	66,1	2 339	1,5	3 605	1,7	54,1
EFTA countries	17 078	10,0	25 801	11,6	51,1	18 903	12,4	24 746	12,0	30,9
Class 2 countries	35 236	20,5	34 873	15,7	−1,0	24 919	16,3	28 139	13,6	12,9
Class 3 countries	3 204	1,9	3 762	1,7	17,4	3 163	2,1	4 230	2,0	33,7
Not allocated	3 884	2,3	4 689	2,1	20,7	3 282	2,1	4 018	1,9	22,4
					Merchandise					
World	636 156	100,0	857 564	100,0	34,8	647 737	100,0	835 998	100,0	29,1
Intra-EC	335 880	52,8	498 271	58,1	48,3	329 290	50,8	484 508	58,0	47,1
Extra-EC	300 276	47,2	359 293	41,9	19,7	318 447	49,2	351 490	42,0	10,4
Class 1 countries	152 458	24,0	218 816	25,5	43,5	158 960	24,5	215 477	25,8	35,6
USA	54 624	8,6	74 437	8,7	36,3	55 117	8,5	63 602	7,6	15,4
Japan	7 390	1,2	15 323	1,8	107,3	22 022	3,4	39 074	4,7	77,4
EFTA countries	64 262	10,1	95 496	11,1	48,6	60 161	9,3	85 941	10,3	42,9
Class 2 countries	115 911	18,2	108 171	12,6	−6,7	123 124	19,0	100 854	12,1	−18,1
Class 3 countries	24 400	3,8	27 295	3,2	11,9	29 084	4,5	28 398	3,4	−2,4
Not allocated	7 507	1,2	5 011	0,6	−33,2	7 280	1,1	6 761	0,8	−7,1

Values are in million ECU. Rates of growth are between the two periods. Class 2 countries concern developing economies. Class 3 countries concern non-market economies.
Sources: OECD-Eurostat (1991); author's computations.

vices. Lastly, the difference between intra- and extra-EC trade growth in services is smaller than the difference observed in the case of trade in goods.[1] All together, these observations are consistent with an early impact of the SMPS, albeit a modest one, since so far there has been no catching-up effect *vis-à-vis* trade in goods.

Table 69 provides a breakdown of EC cross-border trade in services by sector. A first indicator is the 'openness ratio', i.e. the share of total (extra-EC and intra-EC) imports in services with respect to the EC GNP. For the two periods, the ratios are four times smaller than the corresponding ratios for the manufacturing sector, a result which confirms the striking difference between trade levels in services and in goods observed for all the OECD countries (Hoekman, 1991). Table 69 also allows the examination of the changes in intra-EC trade share with respect to total (extra-EC and intra-EC) trade in services between the pre- and post-SMPS periods. It shows a substantial increase in intra-EC trade shares between the two periods. At this early stage of the SMPS, these changes can reflect either the SMPS liberalization process concerning both intra-EC and extra-EC trade (with a more important impact on the intra-EC side), or the effects of the existing Member State protection against non-EC providers of services. Finally, the relative growth rate (intra-EC trade compared to total EC) for the whole service sector is still lower than the relative growth rate observed

[1] High growth rates of cross-border trade with Japan are partly due to the low initial figures, and also to the rapidly expanding links between the Japanese and EC economies (as shown by data on merchandise).

Table 69

Sectoral breakdown of cross-border services trade of the Community

Sectors	1980-85		1986-89		Relative rate of growth[1] (%)
	Average	Variance	Average	Variance	
Openness ratios[2]					
Merchandise	23,5		21,2		
All services	5,6		5,2		
Intra-EC trade share of the EC total trade[3]					
Merchandise	52,8	0,9	58,0	2,9	38,9
All services	41,3	0,6	44,3	1,6	33,6
Travel	52,1	7,5	53,2	1,0	10,3
Sea freight	38,1	1,3	38,1	0,8	−14,5
Sea passenger	41,3	0,9	48,1	2,9	79,5
Air freight	22,2	3,1	24,5	1,9	31,2
Air passenger	25,3	0,9	27,7	6,9	53,0
Other transport	50,3	0,8	49,2	1,5	−17,7
Banking	28,6	0,6	32,7	4,4	30,1
Insurance	18,6	1,9	20,5	13,7	21,6
Trade earnings	42,9	1,1	46,0	2,3	40,4
Advertising	48,8	2,3	52,8	6,5	24,3
Business services	32,1	1,3	42,0	8,7	244,6
Construction	12,0	1,4	18,3	1,8	−150,7
Telecommunications	30,7	0,6	32,7	3,9	23,0
Films and TV	22,8	2,1	35,6	6,1	139,2
Patents incomes	32,3	0,4	33,9	0,2	14,7
Other services	48,2	0,9	50,9	13,4	17,3

[1] Ratio of the growth rate for intra-EC trade with respect to the growth rate for total EC trade.
[2] Total (extra- and intra-EC) debits as a per cent of the GDP of EC 12.
[3] Intra-EC credits as a per cent of the total (extra- and intra-) EC credits.

Sources: OECD-Eurostat (1991); author's computations.

for goods, and is likely to reflect the fact that the SMPS is still at an early stage.

Tables 70 and 71 present the share of each Member State in extra-EC trade for the more recent period (1986-89). The fact that data are not of equal quality among EC Member States (for instance, the German shares in the extra-EC trade in banking are largely related to data problems) limits the range of robust observations. The shares of the whole services sector (in terms of debits) are relatively close to the shares of goods for all the EC Member States. Table 72 also presents the growth rates for the pre- and post-SMPS periods of the shares held by EC Member States in extra-EC trade. It shows that several changes have affected all the Member States (such as construction), whereas most changes may reveal ongoing structural adjustments in each Member State.

1.3. Establishment-based competition in EC services

Protection imposed until 1986 by most Member States against intra-EC and extra-EC service providers is likely to have discouraged cross-border trade in services, and thus to have favoured (in relative terms) other forms of competition, in particular through establishment-based competition (which in turn may tend to further reduce incentives to cross-border trade).

Table 73 provides two crude indicators for measuring the intensity of the establishment-based competition in services in the Community, foreign direct investment and the number

Table 70

Share of each Member State in extra-EC cross-border trade in services (average shares in extra-EC debits for 1986-89)

Service industries	B/L	DK	D	GR	E	F	IRL	I	NL	P	UK
Travel	4,7	3,6	39,6	1,1	3,9	17,0	0,2	3,8	7,0	0,7	18,6
All transport services	7,5	6,6	17,3	1,0	4,5	14,4	0,9	17,1	11,4	0,9	18,5
Sea freight	12,7	4,0	12,9		5,1	8,6		26,5	19,2		7,7
Sea passenger	[1]	0,4	50,6		1,0	5,9		18,6	1,4		20,5
Air freight	14,9	0,3	7,4		2,0	22,0		18,1	4,5		22,8
Air passenger	3,0	0,5	21,9		3,2	18,7		8,5	6,6		35,3
Other transport	4,1	13,2	19,5		4,8	17,8		11,6	6,5		20,6
All other services	7,9	2,8	29,4	1,0	3,2	19,5	0,7	16,8	6,4	0,5	11,5
Banking	13,2	0,5	2,0		2,1	52,8		24,0	3,1		
Insurance	7,9	3,5	23,8		9,9	23,5		22,5	5,5	1,5	
Trade earnings	9,5	4,2	36,8		4,0	13,5		16,9	9,6		4,0
Advertising	7,0		30,8		3,9	15,3		22,5	15,6		
Business services	9,2		24,2		3,1	20,1		20,5	9,5		7,3
Construction	2,1		47,3		0,6	14,1			[a]		
Telecommunications			29,3		1,6	8,3		4,7	3,8		39,2
Films and TV	2,0	0,6	15,5		4,3	14,0		23,7	9,0		28,5
Patents incomes	7,4	3,6	25,5		3,5	16,2		7,8	10,9		22,6
Other services			33,8		2,2	21,3			1,6		
All services	6,9	4,3	27,2	1,0	3,7	17,8	0,6	13,7	8,2	0,7	15,6
Merchandise	6,8	3,0	26,8	1,2	5,8	15,2	1,1	12,4	7,4	1,2	19,2

[1] Negative data have been disregarded.

Sources: OECD-Eurostat (1991); author's computations.

Table 71

Share of each Member State in extra-EC cross-border trade in services (average shares in extra-EC credits for 1986-89)

Service industries	B/L	DK	D	GR	E	F	IRL	I	NL	P	UK
Travel	2,9	3,9	11,9	3,7	16,1	23,3	1,0	10,9	2,6	2,6	21,0
All transport services	7,3	10,0	16,6	2,2	4,8	15,6	0,7	12,8	11,8	0,9	17,1
Sea freight	12,8	12,7	11,7		2,4	9,1		26,1	4,2		15,6
Sea passenger	0,9	5,5	4,4		0,7	5,1		29,0	0,9		49,8
Air freight	18,8	1,4	27,7		1,2	20,1		4,6	7,2		17,1
Air passenger	3,3	3,0	21,9		7,5	14,3		10,4	8,7		28,4
Other transport	2,9	13,5	16,6		6,3	22,1		2,8	22,0		10,2
All other services	7,7	2,3	18,8	2,0	2,2	19,9	0,3	14,8	5,6	0,4	25,8
Banking	9,6	0,3	5,5		1,8	24,7		14,5	2,7		38,4
Insurance	4,3	0,9	5,9		3,0	15,8		9,0			58,9
Trade earnings	10,4	3,7	19,1		4,4	7,3		20,1	11,1		20,9
Advertising	12,4		17,2		3,6	19,0		16,8	19,6		6,1
Business services	10,7		14,5		1,2	25,3		10,6	6,5		26,1
Construction	1,4	0,7	37,5		0,9	19,3			5,2		
Telecommunications			27,8		3,6	12,1		6,0	3,5		32,9
Films and TV		0,3	3,9		3,5	14,9		8,9	10,6		54,7
Patents incomes	5,1	4,9	22,0		0,6	12,6		3,8	7,2		41,1
Other services			22,6		2,1	26,6			3,9		
All services	6,3	5,0	15,9	2,4	6,3	21,5	0,6	12,8	6,7	1,1	21,3
Merchandise	6,5	3,3	34,0	0,6	3,1	14,9	1,3	13,3	5,6	0,7	16,8

Sources: OECD-Eurostat (1991); author's computations.

of mergers and acquisitions.[1] These indicators provide two interesting results. Intra-EC inflows of foreign direct investments have increased more than extra-EC inflows, in apparent contradiction to the more numerous extra-EC than intra-EC mergers and acquisitions (*stricto* or *largo sensu*). However, these two diverging evolutions may be reconciled. Non-EC firms may view mergers or acquisitions as a more necessary step for the post-SMPS period than do EC-based firms which may consider themselves to be adequately 'European' so as to avoid this form of investment. Second, concerning the comparison between services and manufacturing, the two indicators provide the same results, at least if one looks at the intra-EC aspect *stricto sensu*. Growth rates for services at the extra-EC level are larger than growth rates for manufacturing, whereas they are lower at the intra-EC level. Moreover, it is interesting to observe that mergers and acquisitions are increasing more rapidly in services than in goods at the intra-Member State level. This evolution may indicate that EC service providers are preparing the post-SMPS period by creating larger 'national' firms, an evolution which may mirror the willingness, either to lower transaction costs when building larger firms, or to put internal (Member State) markets under increased control.

These results raise the following question: will the dismantlement of trade barriers in services lead to a profound change in the relative role of cross-border trade and establishment as the two alternative instruments of international competition in services? Answering this question requires a comparison between the growth rates of cross-border trade in services (Table 68) and the growth rates of establishment in services (Table 73). Bearing in mind the low quality of the available data, the differences in the growth rates are large enough to suggest that, so far, the SMPS has triggered a more marked evolution in terms of establishment-based competition than in terms of cross-border-trade-based competition.

[1] Sapir (1991) provides evidence on world market shares (in terms of sales) for the largest firms in certain service and manufacturing sectors.

Table 72

Changes in shares of each Member State in extra-EC cross-border trade in services (growth rates between 1980-85 and 1986-89)

Service industries	Extra-EC credits							Extra-EC debits						
	EC	B/L	D	F	I	NL	UK	EC	B/L	D	F	I	NL	UK
Travel	41,0	39,2	45,3	45,3	15,6	32,2	30,8	50,8	34,5	40,1	52,6	91,1	33,9	72,5
All transport services	14,3	14,2	11,5	18,0	35,2	3,1	−3,8	15,2	8,2	5,9	10,3	49,4	4,9	11,7
Sea freight	4,8	25,2	−23,9	−35,4	79,8	−12,5	−16,2	6,0	9,5	−21,1	−31,2	56,8	13,7	−19,1
Sea passenger	11,9	−63,2	100,5	1,9	26,4	−9,3	6,0	46,5	−345,5	45,8	65,4	237,5	11,1	42,8
Air freight	37,3	64,5	53,9	39,0	31,5	2,1	11,2	40,1	54,8	104,6	39,4	42,5	10,5	22,0
Air passenger	20,2	17,7	26,4	0,9	8,6	2,0	28,8	52,7	−8,8	40,5	48,7	138,6	10,9	70,2
Other transport	17,4	−32,6	26,6	82,7	−47,0	6,8	−24,2	8,8	5,3	12,3	28,1	17,0	−17,7	−4,4
All other services	21,0	13,3	7,6	2,4	55,8	24,7	32,6	25,5	20,5	22,1	24,0	39,9	21,4	9,2
Banking	108,4	106,9	63,3	280,4	14,6	74,5		52,1	159,3	44,5	300,8	−42,6	49,1	
Insurance	66,8	82,6	71,9	39,5	60,6			42,1	85,3	35,0	22,9	45,8	5,3	
Trade earnings	15,9	−1,0	−9,2	−10,5	47,4	20,3	27,1	17,9	−8,5	19,3	7,2	36,9	6,5	39,2
Advertising	42,1	35,8	73,4	−0,1	148,6	25,5		43,9	40,0	55,2	−18,3	150,2	28,5	
Business services	−2,3	−22,2	46,3	−14,3	35,8	28,3	−13,2	8,1	−36,1	19,6	46,3	59,7	5,4	−53,8
Construction	−30,8	−46,8	−36,1	−47,9		−21,2		−37,1	−41,5	−45,7	−36,6		−119,9	
Telecommunications	40,0		61,3	24,9	36,5	113,1	28,0	41,0		55,4	1,5	88,3	74,5	32,8
Films and TV	39,3		8,1	210,1	34,7	90,6	16,2	86,3	93,5	45,7	191,0	105,4	51,2	77,7
Patents incomes	53,5	76,6	61,5	58,6	40,4	102,2	42,7	59,4	66,4	71,6	33,0	−1,1	79,0	79,4
Other services	48,4		48,8	8,9		25,2		43,8		68,4	−0,7		−18,6	
All services	22,6	17,5	14,3	15,6	40,3	12,2	21,0	25,6	17,3	23,2	20,8	46,6	14,6	22,9
Merchandise	19,7	9,5	34,1	11,7	18,3	19,9	7,4	10,4	6,3	21,0	5,7	−5,5	1,3	23,7

Sources: OECD-Eurostat (1991); author's computations.

2. Analytical context

As underlined by Sapir and Winter (1991), 'services have generally been ignored by trade economists on the ground that they are "non-traded" activities'. The early 1980s witnessed the first studies on international trade in services. These studies were empirical, and written at a time when there existed virtually no theoretical papers specifically devoted to trade in services: their main objective was to test the hypothesis that trade in services is as consistent with cross-country differences in factor endowments and technology as trade in goods. Evidence provided by Sapir and Lutz (1981) gave the first robust support to the general presumption that services and goods follow similar economic rules.

The rest of the 1980s witnessed a large increase in interest about trade in services as a result of a two-way influence between academics and trade officials.[1] The starting-point was the US initiating document submitted to the GATT in 1982 which underlined the importance of services to the world economy and called for a more liberal approach to trade in services (Lazar, 1990).

The US text and the reactions triggered reoriented economic analysis in three directions. First, the close link the US document created between services and goods in terms of negotiations (through a marked reference to the GATT) prompted a large literature on the differences between services and goods in terms of their economic nature, and on the economic implications of these differences. Second, the focus of the US text on a liberal approach generated strong incentives to check the existence of the theoretical underpinning necessary for recommending free trade policy, i.e. proof that the principle of comparative advantage in the case of trade in services is as rigorous as the proof in the case of trade in goods. Third, the US document left the impression that liberalization of trade in services would lead to 'dualistic' patterns of specialization (i.e. where a few industrialized countries would export services to the rest of

[1] For a detailed presentation of the empirical and theoretical studies on trade in services, see Sapir and Winter (1991).

Table 73

Establishment in EC services: foreign direct investment, mergers and acquisitions (1984-89)

	Years[1]						Periods		
	1984	1985	1986	1987	1988	1989	1984-85	1986-89	Growth (%)
	Foreign direct investment inflows to the Community (billion ECU)								
	Intra-EC inflows								
Total	4,4	5,7	10,4	11,7	23,0	n.a.	5,1	15,0	197,7
Manufacturing	1,3	1,6	3,8	4,1	10,3	n.a.	1,5	6,1	318,4
Services	3,1	4,4	6,2	8,1	12,5	n.a.	3,8	8,9	138,2
	Extra-EC inflows								
Total	6,2	5,6	6,8	12,6	14,3	n.a.	5,9	11,2	90,4
Manufacturing	2,4	2,0	1,7	5,1	5,2	n.a.	2,2	4,0	81,8
Services	3,7	3,2	4,9	7,1	8,6	n.a.	3,5	6,9	99,0
	Mergers and acquisitions in the Community (number of operations)								
	Intra-Member State operations								
Total	193	189	290	321	352	353	191	329	72,3
Manufacturing	146	145	211	214	233	241	146	225	54,5
Services	47	44	79	107	119	112	46	104	129,1
Distribution	30	27	40	40	53	31	29	41	43,9
Banking	10	12	22	53	51	65	11	48	334,1
Insurance	7	5	17	14	15	16	6	16	158,3
	Intra-EC (stricto sensu) *operations*[2]								
Total	60	65	90	145	225	315	63	194	210,0
Manufacturing	44	52	75	111	197	257	48	160	233,3
Services	16	13	15	34	28	58	15	34	132,8
Distribution	3	6	5	8	4	17	5	9	88,9
Banking	6	4	3	12	16	23	5	14	170,0
Insurance	7	3	7	14	8	18	5	12	135,0
	Intra-EC (largo sensu) *operations*[3]								
Total	253	254	380	466	577	668	254	523	106,2
Manufacturing	190	197	286	325	430	498	194	385	98,8
Services	63	57	94	141	147	170	60	138	130,0
Distribution	33	33	45	48	57	48	33	50	50,0
Banking	16	16	25	65	67	88	16	61	282,8
Insurance	14	8	24	28	23	34	11	27	147,7
	Extra-EC operations[4]								
Total	22	43	35	92	89	165	33	95	193,1
Manufacturing	18	30	17	58	62	124	24	65	171,9
Services	4	13	18	34	27	41	9	30	252,9
Distribution	1	0	4	9	1	4	1	5	800,0
Banking	2	9	10	13	16	25	6	16	190,9
Insurance	1	4	4	12	10	12	3	10	280,0

[1] Fiscal years for mergers and acquisitions.
[2] Operations involving firms from different EC Member States.
[3] Operations involving firms from the same EC Member State or from various Member States.
[4] Operations involving firms from outside the EC.

Sources: Sapir (1991); *EC Report on Competition Policy*, various years.

the world, and import goods from the rest of the world), a perspective which generated many questions from countries which did not deregulate their service industries.

Are services similar to goods?

The US proposal underlined the role of GATT as a 'solid' basis for a framework for trade in services. This insistence on the similarity between goods and services has led to a large literature analysing the consequences of the different economic nature of services and goods. This search for the theoretical grounds of the specific nature of services has led to two major conclusions.

The first crucial difference between the nature of services and goods is the non-storability of services (Bhagwati, 1984; Sampson and Snape, 1985). It echoes the focus of the US 1982 proposal on the 'right of establishment' in trade in services (a focus without equivalent in trade in goods). It led to a typology of trade in services comprising four types. Pure cross-border trade in services corresponds to traditional trade in goods, where producers located in one country export their services to consumers located in another country. Trade in services based on factors which are internationally mobile occurs when one of the two agents travel to the other country in order to produce (mobile providers) or consume (mobile users) the service. Last but not least, trade in services based on 'factor establishment' occurs when service providers create permanent subsidiaries in the 'importing' country in order to produce and sell the services, a type of trade which is similar to trade in goods associated with foreign direct investment and/or labour movement.

The second crucial difference between services and goods underlined by the literature is the intangible nature of services, that is, the fact that services 'exist' only when they are being consumed, implying that the quality of services generally cannot be assessed before they are consumed. Information is therefore important for services. As a result, both producers (to develop a policy of goodwill and reputation) and public authorities (by elaborating norms in regulations) have incentives to produce information.

This comparison between goods and services may seem rather abstract. However, Section 4 shows it has a considerable impact on the way services can be liberalized for two reasons. First, the typology of four types of trade in services has been the analytical support for the definition of the 'modes of supply' adopted by the Uruguay Round draft on services. Second, the mere existence of this typology is likely to have an important impact on the liberalization process. As suggested by Hindley (1987), liberalization based on freer establishment rules maintains the coexistence of different regulations in the trading partners, whereas liberalization based on opening cross-border trade implies a direct competition between these diverging regulations through the types and prices of the competing services. In sum, the potential in terms of competition of these two types of liberalization may be quite different.

Is the principle of comparative advantage verified for trade in services?

The US proposal created hesitations among industrialized countries (including EC Member States) and faced fierce opposition from developing countries (in particular, from Brazil and India). As a result, the US document, though written for practical negotiating purposes, created a strong incentive to verify the theoretical basis for recommending a free trade policy for trade in services, i.e. to get rigorous proof of the principle of comparative advantage. The principle states that the price of goods imported once trade is liberalized is lower than their price under autarky.

Deardorff (1985) demonstrated the validity of this principle in a first case based on the Heckscher-Ohlin framework and is well adapted to countries having reached the same stage of development (with trading partners using the same technologies). This model assumes that two economies produce one good and one service from two factors which are labour and 'management', that the service sector uses management intensively as an input and that the domestic economy is well endowed with management. Thus, it can be shown that in autarky, the relative price of services (with respect to the price of the good) is lower in the domestic economy than in the foreign economy. The consequences are twofold: in autarky, the salary of the managers is lower at home, and once trade is possible, the domestic economy will export the use of its management factor, in order to pay for importing goods from the foreign country. Thus, the principle of comparative advantage is verified.

Jones (1985) completed Deardorff's results by examining a more complex case based on a Ricardian framework (where the trading partners use a different technology for producing the service) which is better adapted to analysing trade between countries at different stages of development. The model assumes that the domestic country has a (Hicksian) neutral technological superiority. The salary of domestic managers (in terms of the price of the good) is higher than the salary of foreign managers. When this gap is less than the productivity edge favouring domestic managers, once free trade is possible, domestic managers will work for foreign enterprises while remaining in their home country. This export flow seems to contradict the principle of comparative advantage. However, it is not contradictory since high qual-

ity domestic managers have higher productivities than their foreign counterparts. The salary of domestic managers, once adjusted for quality, is lower than the salary of foreign managers, a result which makes the export flow mentioned above consistent with the principle of comparative advantage.

Will trade liberalization in services lead to dualistic trade specialization patterns?

Behind the US 1982 text, there was the perception that the USA and the few industrialized countries which were deregulating their services sectors were losing comparative advantage in goods while they were enjoying rising comparative advantage in services, hence their need for freer access to service markets in trading partners in order to compensate the evolution in trade in goods. As a result, trade officials during the late 1980s were concerned by the potential impact of trade liberalization in services. Will liberalization necessarily lead to 'dualistic' trade specialization patterns which many countries are unlikely to accept? This concern has led to three main conclusions.

Many services are an intrinsic part of the infrastructure of an economy: for instance, transport or telecommunications are used for producing and for trading goods (in other words, these services are intermediate products), and giving up all these services to foreign firms could create political problems. Economic analysis shows that dualistic trade specialization patterns are not likely when services are intermediary products, as best illustrated in two crucial cases examined by Burgess (1990). First, in a model with cross-country differences in technologies necessary for the production of services, cheap services in the country with advanced technology may confer comparative advantage in goods that use services relatively intensively in their production, alternatively, they may not confer such an advantage (in this case, it might be the manufacturing industry that uses intensively the factor employed intensively in the service sector which will expand). Second, free trade in services and goods could well lead to the survival of the service sector in the country with the inferior technology; specialization may result in the contraction of one of the industries producing goods rather than of the service sector.

In the second case examined by Burgess, the intangibility of many services implies that they may be produced and purchased in markets characterized by imperfect competition. For instance, services which are prone to customerization generate strong incentives for discrimination, which may induce service providers to implement price discrimination policies and/or non-price (monopolistic) competition. Does the introduction of imperfect competition increase the risks of the emergence of dualistic trade specialization patterns? Jones and Kierzkowski (1989) have shown that the liberalization of trade in services ensures a more efficient international allocation of production under pure and imperfect competition, and that, in the latter case, it helps realize the potential economies of scale, also by an increased geographic specialization of production among trading partners.

Lastly, if the heavy regulation imposed on services in most countries has been perceived as a source of backwardness, it has also led to the conclusion that once deregulated, the formerly protected service industries will not be able to compete with innovative and well-established firms used to a more open environment; and as a result, they should be granted transitory protection. This renewed version of the familiar 'infant industry' argument was apparently reinforced by the abovementioned problem of the information about the quality of services: information that established foreign firms could use as a barrier against the entry of cost-efficient domestic entrants seemed to provide a valid reason for temporary protection. It was thus important to examine this suggestion: Grossman and Horn (1988) have shown that temporary tariff protection to promote entry of domestic firms lowers the welfare of the country for two reasons: it does not change the incentives domestic firms have to provide high-quality goods and it generally reduces consumer surplus. As a result, there are no new and robust theoretical foundations for dropping trade liberalization in favour of transitory protection for infant industries in the case of services.

In sum, the last decade has provided theoretical foundations reinforcing the empirical approach taken by Sapir and Lutz, and the statement by Hindley and Smith (1984) that there is no need for a specific approach to trade in services. Trade liberalization in services is unlikely to bring dualistic specialization patterns under perfect or imperfect competition and trade instruments (such as tariffs) are not the best solution to the complex problems of information and reputation related to the intangibility of services (confirming the usual results of the theory of distortions).

3. Policy towards services

Before looking at the liberalization processes launched by the SMPS and the GATS, it would be useful to have a structured survey of the major policy instruments which disrupt international competition in services. This section presents a crude overview of the major barriers in services for the two most important trading partners, the USA and the Community: a short presentation is then undertaken of

the major sectors for which countries are ready to negotiate trade liberalization in the Uruguay Round.

3.1. A typology of restrictions on international competition in services

A catalogue of the major barriers restricting international competition in services will be increasingly important in the future for two reasons. The first is related to international issues. During the past five years of negotiations of the GATS, the most urgent task has been to conceive a liberalization mechanism. However, in the future, the 'trade policy review mechanism' (i.e. the review of the trade policy of each GATT member by the GATT Secretariat on behalf of all the contracting parties) will be introduced in services, and this procedure will require some kind of systematic and standard framework to be imposed on all the reviewers and reviewed countries as has been the case for trade in goods. The second reason is related to domestic issues. To estimate *ad valorem* equivalents of existing restrictions in services is very difficult, and hence the economic costs of these restrictions are seldom known, as in the case for goods where similar measures are applied. Quite independently of the question of opening up trade in services, the mere recognition of the role of service industries in the domestic economy will generate a growing demand for a better assessment of the net costs of the policy instruments, and a desire to shift to more transparent barriers, in line with moves in the Uruguay Round negotiations to shift barriers on trade in goods from quotas to *ad valorem* tariffs (so-called tariffication).

A first taxonomy of policy instruments has been suggested in the context of the GATS negotiations for the presentation of the schedules of offers by the various countries. This taxonomy consists of four essential types of policy measures based on two criteria: quantitative measures versus 'qualitative' measures (that is, requirements that service providers meet certain regulations, standards or qualifications, as covered by GATS Article VI); and discriminatory versus non-discriminatory measures. This first taxonomy is adapted to the goal of presenting trade offers. However, the future requirements of a TPRM-type approach and the prerequisites for analysing domestic policies in services may require a more detailed catalogue which could be structured along the following lines.

Quantitative measures could be split into quantitative restrictions on domestic consumption (hereafter consumption quotas), quotas on imports and exports, and quotas on inputs. Consumption quotas which reserve all or part of domestic demand for domestic service providers offer a palatable feature for risk-averse policy-makers: they erect the most severe barriers in case of economic downturns and thus are particularly suitable for the stabilizing role of services.[1] Consumption quotas have two other valuable features for policy-makers. Their protectionist impact is independent of the degree of substitution between foreign and domestic services, in sharp contrast with other instruments, such as quotas on imports. Also, their enforcement often requires the involvement of domestic service providers as the *de facto* 'agency' in charge of monitoring the protection. As a result, such quotas more easily give domestic service providers a stronger grip on the protection imposed and its associated rents.

All these features explain why consumption quotas are by far the most frequently used measures for regulating service industries as shown by the following indicative list. Domestic monopolies leave a zero market share to foreign service providers. Domestic sales requirements allow market shares for foreign providers of services larger than zero, but fixed at some predetermined level. Public procurement corresponds to cases where the consumer is a public authority which decides the market share to be left to foreign service producers on a transaction-by-transaction basis. Limitations on production or business scope are equivalent to domestic monopolies or domestic sales requirements for a limited range of differentiated services. Licensing procedures can be granted by the public authorities with the view that the foreign producers as a whole should not go beyond some maximum number of operators or market share, and are often used as lax forms of monitoring market shares held by foreign producers.

This long list is in sharp contrast with the relatively short list of quotas on imports used against foreign service providers, essentially quotas imposing targets on import-substitution or trade balances, and limits on trans-border movements of consumers. Quotas on exports are also rare except under the form of export prohibitions of services (for national defence) and limits on trans-border movements of producers (scientists in certain fields).

However, experience has induced policy-makers to be aware of the negative consequences of import/export quotas. Such quotas tend to create powerful domestic lobbies operating in non-competitive markets. As a result, they often lead

[1] This motive flows from the fact that services have been perceived (rightly or wrongly) as labour intensive (indeed, most of them have been labour intensive and many services still are) and hence are a source of counter-cyclical stabilization in terms of growth and employment. During recessionary periods, service providers have often been slower to reduce their levels of employment and they have often undergone smaller adjustments. In sum, policy-makers see services as shelters.

to the conclusion that the protection has been excessively captured by domestic service producers and that it has imposed 'too large' a cost on domestic consumers. When policy-makers have been influenced by these considerations, they have tended to rely on quotas on inputs for two reasons. First, limiting the quantities of a crucial input for producing a specific service can provide the same level of protection as a consumption quota. However, it does so by providing tangible protection of the quantities used of certain physical inputs (such as steel in public works, vessels in shipping, etc.) which can be monitored by public authorities without the cooperation of the domestic service providers, and can also open up the possibility of politically profitable transfers under the aegis of public authorities (for instance, the domestic steel industry benefits from restrictive rules in public procurements concerning construction). Second, quotas on inputs can help control the economic consequences of consumption quotas (or quotas on imports) related to the capture of rents by primary factors (workers or owners). Consumption quotas are usually accompanied by rents which can be captured by foreign owners of domestic firms if there are no limits on foreign ownership, or by foreign workers in domestic firms if there are no constraints on the composition of the work-force or on the technology used (foreign skilled labour could obtain rents through the use of foreign technology).

Such a wide range of considerations helps to explain the frequent use of quotas on inputs. These quotas include restrictions on foreign ownership and employment of skilled or unskilled labour, domestic content requirements, measures (if used in a discriminatory manner) such as norms and standards, rules on copyrights and trade marks, and requirements on technology and external financial transfers (including foreign exchange controls which impose limits on the availability of foreign currencies, i.e. essential inputs for trading services or inputs which are necessary for producing services).

The need to control the economic consequences of consumption quotas also explains that the most frequent price measures observed in services are minimum and maximum prices, whereas *ad valorem* or specific tariffs which are the most common protectionist instruments in trade in goods are rare, except under the form of price preferences (*ad valorem* price margins granted to domestic services competing with foreign services in tenders). Maximum and minimum prices have a strong impact on the structure of domestic service markets. Maximum prices are often imposed by the government in order to limit the monopoly power of domestic service providers and the total value of associated rents (maximum prices have no impact on the sharing of the rents). Minimum prices are often imposed by governments in order to give public support to uncompetitive pricing and to eliminate what the government is led to consider as 'excessive' competition, by sending a clear signal to all firms to align their own prices to the minimum price. As a result, maximum and minimum prices can often be used in conjunction with consumption quotas. For instance, maximum prices can be used by a government for limiting the monopoly power generated by a consumption quota imposed by the government itself, and minimum prices can induce domestic firms not to expand their existing market shares by price-cutting, i.e. they can impose a set of implicit quotas between firms operating on the service market in question.

Finally, the above considerations yield a last set of measures aimed at providing a competitive environment through competition laws or laws specifying property rights and an adequate level of information about the quality of the services through prudential or disclosure rules, protection of investors' and workers' rights.[1]

3.2. EC and US barriers against foreign services

Table 74 is based on two catalogues of the major barriers to trade in services elaborated by the US Trade Representative (*Foreign trade barriers*, 1985) and by the EC Commission (*US trade barriers and unfair trade practices*, 1990). It is essential to note that these two catalogues do not have a common methodology. The USTR document relies on a survey of the major barriers imposed by US trading partners against US providers and exporters of services in many countries. Though it is relatively systematic, it still mirrors the interests of the surveyed firms (implying that it may overestimate the scale of barriers in sectors and Member States where US firms would like to export more, and underestimate the barriers in the other services sectors and Member States). The EC document on US barriers in services is even more sketchy since it focuses on crucial points of contention between the US and the Community. As a result, the two documents cannot be compared.

The structure of the EC barriers confirms the leading role of the United Kingdom among EC Member States in terms of unilateral service liberalization (Messerlin, 1990). The structure of US barriers is concentrated in service industries that the US negotiators hesitate to introduce into the current round of negotiations (banking and telecommunications) and those which they have clearly excluded (shipping).

[1] Prudential regulations can be associated with competition rules because they increase transparency within the financial services industry, thus reducing the possibility of 'unfair' competition flowing from bad or incomplete information on the financial situation of banks.

Table 74

Main barriers to services trade: EC and US cases

	European Community[1]													USA[2]	
	B	DK	D	GR	E	F	IRL	I	NL	P	UK	Total	(%)	Number	(%)
Airlines	2	1	2	1	2	3	1	2		1	3	18	10,9		
Banking					3							3	1,8	2	16,7
Construction								1			1	2	1,2	1	8,3
Insurance	1	1	4	2	1	1	2	3	1	1	1	18	10,9	2	16,7
Films and TV	2	2	2	2	2	2	2	2	2	2	2	22	13,3		
Business services	2		1		3	4		2	1		2	15	9,1	1	8,3
Telecommunications	2	2	5	2	2	2	2	2	2	2	2	25	15,2	2	16,7
Tourism	1			2	4	2		3		4	2	18	10,9		
Shipping	2	5	4	4	8	4	5	3	5	1	3	44	26,7	4	33,3
All services	12	11	18	13	25	18	12	18	11	11	16	165	100,0	12	100,0
(%)	7,3	6,7	10,9	7,9	15,2	10,9	7,3	10,9	6,7	6,7	9,7	100,0			

[1] Source for all sectors, except shipping: USTR (1985). For shipping: White (1988).
[2] Source for all sectors, including shipping: EC Commission (1990).

Trade balances could be interpreted as a crude indicator of the likely reactions of the concerned service sectors to prospects of liberalization. Under this hypothesis, negative or deteriorating balances, which can be observed in four EC service sectors (telecommunications, advertising, audiovisual and sea freight), are likely to trigger or maintain arguments for protection. Rising positive balances, which can be observed in three EC service industries (banking, insurance, and travel), could help pro-trade arguments. The attitude of the other sectors is more difficult to predict, either because trade balances are positive but deteriorating (air transport and construction) or because no clear trend has emerged (trade earnings).

3.3. Service sectors tabled for negotiation in the Uruguay Round

The offers tabled in the Uruguay Round are elaborated in terms of lists (or schedules) of commitments on service industries that future GATS members are ready to envisage liberalization and negotiate upon. The mechanism of negotiation adopted for services is close to the traditional mechanism adopted for trade in goods: countries have tabled their initial offers of the service sectors or subsectors which they are ready to open, and negotiations may lead to an expansion or a contraction of the initial lists.

Table 75 presents an overview of a few representative offers initially tabled. Offers, which have been aggregated into 16 subsectors or sectors, suggest three observations.[1] First, the offers of industrial OECD countries tend to cover more sectors than those of developing countries and NIEs. Only two NIEs, Korea and Mexico, have tabled initial offers close to the offers of industrialized OECD countries in terms of sectors. Nine out of the 15 developing countries and NIEs have tabled offers covering less than 50% of the sectors. Among the industrial OECD countries, a handful have offers in almost all sectors, e.g. Austria, the Community, Finland, Iceland, and Sweden. Australia is the only industrial OECD country with initial offers covering less than 50% of the sectors. Second, the breakdown of the initial offers by sector presents strong differences. One sector, tourism, is tabled by all countries, and two sectors, education and distribution, are not well covered by the initial offers. Education is a service industry largely dominated by public providers, however the reluctance for opening distribution and franchise is

[1] Table 75 requires three caveats. First, it does not show the possibility that a country can offer to eliminate restrictions on one or several modes of supply, but not on all of them (a crucial consideration, as examined in Section 4). Second, the offers may have different levels of quality which are not reflected by the simple Yes/No classification. Lastly, the table is based on a traditional classification which does not reflect the relative economic weight of the different sectors.

more surprising, and it may mirror the backwardness (and desire for protection) of these sectors in the countries concerned. Lastly, there are wide differences between the sectoral coverage of the two groups of countries. On the one hand, tourism and hotels are tabled in a similar way by the two groups of countries. On the other, developing countries and NIEs are more reluctant to cover certain sectors than industrialized OECD countries. This reluctance may be related to the fact that certain services are much less regulated in developing countries and in the NIEs than in OECD countries (likely for accounting, banking, and franchise). Alternatively, it may be related to the protection of certain producers (likely for computer services, audiovisual media, and education).[1]

4. The framework for liberalization: SMPS versus GATS

At a first glance, the SMPS and the GATS which would emerge from a successful Uruguay Round exhibit a similar formal structure.[2] Both the Treaty of Rome for the SMPS, and the Articles of Agreement for the GATS contain a 'framework' comprising a few general principles. The framework is accompanied by detailed sectoral regulations (the directives and recommendations for the SMPS, the existing and future 'Annexes' for the GATS).

However, these apparent similarities hide fundamental differences about the basic approaches that the SMPS and the GATS have adopted on the rules needed for trade in services. These differences are likely to have a profound impact on the process and extent of liberalization.

4.1. Two different approaches on rules for trade in services

The differences in the economic nature of goods and services mentioned in Section 2 have led policy-makers to a crucial question: are these differences important enough for requiring the imposition of rules on trade in services which are not the same as for trade in goods?

The Treaty of Rome provides a negative answer to this question. Despite the fact that the Treaty devotes distinct Titles for trade in goods and trade in services, it basically imposes identical rules on both. The Chapter entitled 'Services' (Articles 59 to 66) is based on the general concept of 'free delivery' of services, a concept also used for trade in goods, and does not evoke the existence of the four different types of international competition in services which were described in Section 2. The Chapter on 'Establishment' contains provisions to be applied to both producers of goods and providers of services. Only one Article (Article 57) of this Chapter mentions the need for specific rules on 'non-wage activities' (that is, banking and health services); however, it does so only for procedures. Chapter 4 (Articles 67 to 73) on 'Capital' is often presented as the chapter of the Treaty dealing with financial services, but in fact it focuses on exchange controls and free movements of capital; while these two topics are of prime interest for banks and investment firms, they also concern all the services and manufacturing sectors. Lastly, Title IV devoted to 'Transport' (rail, road and inland water) is limited to very general principles, i.e. the need for a common policy, the principle of unconditional non-discrimination, the reduction of economic distortions (aids and taxes), all of which are very similar to those adopted for trade in goods.[3]

In contrast, the GATS provides a positive answer to the initial question. This difference between the SMPS and the GATS is not astonishing. The Treaty of Rome aims at creating free trade in all economic activities (including investment related to trade). The GATS approach follows the GATT line: to create the conditions for 'liberal' international trade in services. As a result, it is, *de facto*, more concerned with transparency and moderate protection than with free trade.

[1] The complexity of the offers is enormous, in particular for federal or quasi-federal trading partners, such as the USA and the Community. For instance, the 180 items included in the detailed list of sectors used in the GATS negotiations on offers (see the Annex) correspond to roughly 1 500 basic 'cells' (180 times four modes of supply for Article XVI and four modes of supply for Article XVII) at the EC or US level. However, EC or US offers require special mention. For instance, looking at the EC offer suggests that this factor can increase by three to four the number of possible combinations (roughly 5 000 to 6 000) making the complexity of negotiations on offers in services close to the complexity of trade negotiations on goods. As underlined by Hoekman (1991), trade negotiations on services can be examined, as can trade negotiations on goods, from two perspectives. The first perspective looks at what the trading partners of the country under consideration have tabled, a 'mercantilist' approach which insists on opening export markets. The second perspective focuses on what the country has tabled, adopting a more economically-sound view of the negotiations focusing on the benefits for the consumers of opening domestic markets to foreign competition.

[2] Both were initiated in the mid-1980s. The SMPS was launched by the 1985 White Paper on the single market, and the negotiations on the GATS followed the 1986 Punta del Este decision to launch world negotiations on services following the 1982 US proposal.

[3] The Treaty of Rome has left aside sea and air transport, without any provision at all (Article 84:2). The Treaty of Maastricht contains new provisions for Articles 73 and 75. These new provisions do not modify the 'neutral' approach between services and goods.

Table 75

Service industries covered for selected country offers

	Developing countries and NICs															All DCs and NICs	
	Argentina	Brazil	China	Colombia	Hong Kong	Indonesia	Korea	Malaysia	Mexico	Peru	Poland	Singapore	Turkey	Uruguay	Yugoslavia	Number	(a) (%)
Accounting	Y	Y	Y				Y		Y		Y	Y				7	46,7
Business services	Y	Y	Y		Y	Y	Y		Y		Y	Y	Y	Y		11	73,3
Computer services					Y		Y		Y		Y	Y		Y		6	40,0
Professional services	Y	Y	Y			Y	Y		Y		Y	Y	Y		Y	10	66,7
Banking			Y	Y	Y		Y		Y					Y		6	40,0
Insurance	Y	Y		Y	Y		Y		Y	Y					Y	8	53,3
Distribution		Y			Y		Y			Y	Y					5	33,3
Franchise		Y														1	6,7
Construction	Y	Y					Y	Y			Y		Y		Y	7	46,7
Audiovisual media					Y	Y	Y		Y		Y				Y	6	40,0
Tourism	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	15	100,0
Hotels, restaurants	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y		Y	Y	Y	Y	14	93,3
Education			Y						Y		Y		Y			4	26,7
Health services						Y		Y	Y		Y	Y	Y		Y	7	46,7
Telecommunications	Y				Y	Y	Y	Y	Y		Y		Y		Y	9	60,0
Transport		Y	Y		Y	Y	Y	Y	Y					Y	Y	9	60,0
Total: number	8	10	8	4	10	8	13	6	13	4	11	7	8	6	9	125	52,1
Total: percentage	50,0	62,5	50,0	25,0	62,5	50,0	81,3	37,5	81,3	25,0	68,8	43,8	50,0	37,5	56,3	52,1	

	Industrialized OECD countries												All industrialized countries		All countries		
	Australia	Austria	Canada	EC	Finland	Iceland	Japan	New Zealand	Norway	Sweden	Switzerland	USA	Number	(b) (%)	Number	(%)	(c)
Accounting	Y	Y		Y	Y	Y	Y	Y	Y	Y	Y	Y	11	91,7	18	66,7	50,9
Business services	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	12	100,0	23	85,2	73,3
Computer services		Y	Y	Y	Y	Y	Y		Y	Y	Y	Y	10	83,3	16	59,3	48,0
Professional services		Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	11	91,7	21	77,8	72,7
Banking		Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	11	91,7	17	63,0	43,6
Insurance		Y	Y	Y	Y	Y	Y		Y	Y	Y	Y	10	83,3	18	66,7	64,0
Distribution		Y		Y	Y	Y	Y	Y		Y	Y		8	66,7	13	48,1	50,0
Franchise					Y	Y						Y	3	25,0	4	14,8	26,7
Construction		Y	Y	Y		Y	Y	Y	Y	Y	Y	Y	10	83,3	17	63,0	56,0
Audiovisual media	Y	Y		Y	Y	Y	Y	Y	Y	Y	Y	Y	11	91,7	17	63,0	43,6
Tourism	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	12	100,0	27	100,0	100,0
Hotels, restaurants	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	12	100,0	26	96,3	93,3
Education		Y		Y	Y	Y	Y	Y	Y	Y			8	66,7	12	44,4	40,0
Health services	Y	Y		Y	Y	Y	Y		Y	Y		Y	9	75,0	16	59,3	62,2
Telecommunications		Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	11	91,7	20	74,1	65,5
Transport	Y	Y	Y	Y	Y	Y		Y	Y	Y	Y	Y	11	91,7	20	74,1	65,5
Total: number	7	15	10	15	15	16	14	12	14	15	13	14	160	83,3	285	66,0	62,5
Total: percentage	43,8	93,8	62,5	93,8	93,8	100,0	87,5	75,0	87,5	93,8	81,3	87,5	83,3		66,0		

Figures in column c are the ratios of figures in column a to column b, in per cent.

Source: Coalition of Service Industries, 1991.

This different approach has an important corollary. As the Treaty of Rome is the foundation of the SMPS, the SMPS has adopted an approach which aims at maintaining equally open the opportunities of trade liberalization in services whether it is provided by cross-border trade (or 'light' establishment, such as branches) or by establishment (subsidiaries of the service providers).

It may be argued that these opportunities of trade liberalization through cross-border trade or through establishment have not been used (and are not used) at the same speed by the Community. Even the Court of Justice, which has been the engine for full liberalization has recognized that liberalization does in fact vary between different modes, as best illustrated in its rulings on insurance and on free movement of labour.[1] Indeed, Section 2 suggests that this tendency should be expected because cross-border trade tends to generate more competition in service markets than establishment alone. As a result, it may be expected that both the regulating authorities and the EC firms concerned will be more reluctant to liberalize cross-border trade than establishment-based trade. Regulatory authorities will lose their powers more rapidly and EC firms will see their rents associated with market segmentation arising through regulations eroded by a more complete competition. However, the crucial point is not the existence of these tendencies but the fact that the Treaty of Rome has a 'built-in' balance between cross-border-based and establishment-based trade liberalization (competition). There are examples where the SMPS has adjusted the pace of these two tracks of liberalization, as shown by measures aimed at giving investment services firms (a strategy which is more based on cross-border trade) the same opportunities as universal banks (a strategy which is more dominated by establishment).

Minimizing differences between cross-border and establishment-based trade liberalization has given the SMPS its typical character based on two elements. The liberalization aspect aims at favouring 'free delivery' through cross-border trade or through establishment, in particular by opening EC markets to service providers already operating and licensed in one EC Member State, i.e. the so-called 'single licence' (passport) or 'mutual recognition' approach. The harmonization aspect imposes minimum common EC rules on the crucial features and behaviour of the service providers and on the main features of the control to be exerted by the home EC Member State (the EC Member State where the provider is established).

In contrast, GATS Article I:2 defines four 'modes of supply' corresponding to the four types of trade in services described in Section 2: cross-border trade, movement of service consumers, movement of service producers, and establishment of service providers in the foreign markets. Also, the crucial GATS Article XVI on market access specifies market access rules 'with respect to market access through the modes of supply identified in Article I', thereby opening the possibility to liberalize only certain modes of supply and introducing a potential discrimination between these modes.

4.2. The impact on the process and extent of liberalization

What is the likely impact of these differences between the SMPS and GATS on the process and extent of liberalization? Clearly, one can convincingly argue that all these differences are a matter of legal presentation, and not ones of substance, in the case of countries determined to completely open their service markets: the GATS draft will easily accommodate countries willing to liberalize the four modes of supply in one move.

However, in the case where countries decide to undertake limited liberalization (by far the most frequent case), the GATS approach is a powerful way to regulate the extent of trade liberalization by limiting it to certain modes of supply.[2] In particular, liberalization limited to the mode of supply 'establishment' may well lead to smaller benefits (because competition in the concerned service market may not be greatly enhanced) and nevertheless create adjustment costs high enough to discourage further steps of liberalization.[3]

[1] For the rulings on insurance, see Section 5.1. A recent ruling on the movement of labour (the 1990 Rush Portuguesa case) restricts intra-EC labour movements in the context of providing services in tightly defined limits (right of a service provider to bring in its own workers, non-access of these workers to the labour market of the service-importing Member State). However, this ruling may reflect the fact that the case emerged during a period of transition characterized by both free delivery of services between Portugal (the country of origin of the service provider) and France (the importing country) and postponed free movement of labour (until January 1993) between Portugal and the Member States of EC 10.

[2] The liberalization of the Korean insurance industry under US pressures is a likely example of such a situation (Cho, 1988).

[3] That services liberalization in recent years has been more establishment-based than cross-border-trade-based may merely reflect the lasting impact of the existing heavy restrictions on services trade, rather than the result of intrinsic economic features. This approach fits the evidence, as suggested by three examples. First, many service industries before World War I were worldwide activities organized in industrial structures similar to those adopted nowadays by manufacturing sectors. Second, goods can be non-storable, as best illustrated by electricity. Third, there might be huge potential substitution effects between goods and services: for instance, the technical advice of highly qualified surgeons could be given without the movement of the surgeons (or of the patients), if adequate HDTV and telecommunications services are provided.

The more segmented approach of the GATS is often explained by technical constraints. The GATS forum would be too large (it would cover a too wide spectrum of different regulatory structures) for getting the consensus required to overcome the costs of defining the minimal harmonization necessary for rendering the principle of recognition introduced by GATS Article VII workable and credible. However, such an argument should not be pushed too far. In many service sectors, industrial countries are probably diverse enough to represent the whole spectrum of the legal structures existing in the entire world, suggesting that the problem of the costs of minimal harmonization can be more easily solved than is often stated.[1] Major difficulties may lie on the other side of the problem. If services firms do not play the same role in developing countries as in industrial countries (as in the case of banks), then the costs associated to minimal harmonization might be higher than the expected gains of developing countries, even if these costs are *per se* low.

5. The impact of the SMPS on world services liberalization

Do these fundamental differences between the SMPS and the GATS approaches mean that the impact of the SMPS is likely to be confined within the Community? Or is the SMPS likely to have an impact on liberalization of world service sectors? There are two reasons favouring the latter hypothesis.

The first reason is related to the role of regulation in the EC services liberalization. The SMPS conceives national regulations as potentially dynamic instruments of competition, and this view is likely to spread at the international level either through reciprocity or 'mimetism' thereby making the SMPS a driving force for exploiting the 'sleeping' opportunities of the GATS.

The second reason concerns the role of competition in services liberalization. The declared goal of the SMPS, to favour competitive markets in services, contrasts with the GATS Article VIII which adopts a neutral attitude *vis-à-vis* market structures, and hence is also likely to have an impact on the rest of the world services.

5.1. Regulations and services liberalization

EC authorities often insist on the fact that the SMPS aim at 'liberalizing' services, not at deregulating them. This insistence has often been seen as reflecting political sensitivities, e.g. an opposition to the US 'deregulations', and/or as a basic instinct for regulating.[2]

These explanations miss an essential point. The SMPS is anchored in a crucial ruling of the European Court of Justice (the so-called Cassis de Dijon ruling) which conceived national regulations as dynamic instruments of competition, a vision which has led to the principles of mutual recognition and minimal harmonization. Leaving the 'non-harmonized' portions of national regulations in the hand of the EC Member States will improve (rather than deteriorate) the welfare of the EC consumers, because it provides EC consumers with a choice between services differentiated by alternative regulatory frameworks applying in each Member State. What follows is a presentation of this concept of 'competitive national regulations' and its potential extension to non-EC countries through reciprocity or mimetism.

'Competitive' national regulations

Regulations provided by State (or private) regulators can be seen as inputs for producing services, often leading to the conclusion that services are systematically more 'regulation-intensive' than goods. There are no strong economic arguments suggesting that this relatively higher intensity should be a permanent feature of all services, as illustrated in the three following examples. Food products have become more regulation-intensive than many services (and than most other goods). The fact that retail services are tightly regulated often reflects anti-competitive intents rather than a real need, and removing these regulations will be beneficial to the consumers. Even the banking sector, in one of its wide varieties of niches, can provide counter-examples to the allegedly higher 'regulation-intensity' of services: 'J. P. Morgan and perhaps Bankers Trust are so well capitalized and diverse that they probably could operate quite profitably in the marketplace without the cushion of deposit insurance and without direct access to the bank payments system for clearing financial transactions.'[3]

[1] The costs for adopting minimal harmonization are twofold. There are costs related to the political consensus before the adoption of the harmonization, and there are costs after the adoption of minimal rules (because of ambiguities) which require legal, not political, procedures, e.g. through the European Court of Justice.

[2] The substantial deregulation in the USA has been thoroughly debated by Kasper (1988) for airlines and Crandall (1990) for telecommunications.

[3] Robert Litan quoted by the *National Journal*, 14 December 1991, p. 3012.

The general perception of regulation-intensity makes more difficult the definition of trade liberalization (Kay and Vickers, 1990; Hoekman, 1991). Regulations reducing discrimination against foreign producers are not enough to free trade: e.g. a domestic monopoly eliminates discrimination between foreign providers without liberalizing trade. Alternatively, trade liberalization does not necessarily imply complete deregulation: potential consumers may have different levels of risk aversion and/or information costs, and they may be better off if they face different rules between which they can choose (by buying the corresponding services). In sum, competition through differentiated services may improve welfare and it may require the inputs of different regulations.

As a result, liberalization in services is a balance between eliminating regulations imposing barriers to enter national markets and keeping (or improving) regulations which provide the provisions necessary for producing an economically-sound differentiation between the competing services. This balance is delicate because provisions aimed at providing competition through differentiated services can also impose barriers to entry.

The SMPS close parallel between trade in goods and services has rendered service providers as the active agents in charge of assessing the competitiveness of regulations. 'Inefficient' rules will be removed or modified by EC Member States when the Member State authorities observe that their national services providers are increasingly supplying services from other EC Member States which provide better 'regulatory inputs' (as best illustrated by the sharp and permanent competition between a few Member States for regulating financial markets during the few last years). Competitive pressures come from the fact that EC services providers have the widest possible range of instruments of competition at their disposal, ranging from establishment through subsidiaries to establishment through branches and cross-border trade.

EC producers (and consumers) can lodge complaints with the European Court of Justice (hereafter, the Court). In the mid-1980s, a few 'pockets' of competitive markets shaped by unilateral liberalizations in EC Member States (particularly the United Kingdom) have generated firms (and consumers) eager to see their rights to competition more strongly enforced. These firms (and people) went to the Court which then was in the crucial position of designing the basic principles of the SMPS (and elaborating on specific problems of competition in typical cases, as shown below). Indeed, the role of the Court in shaping the SMPS has been more crucial than the actions of the Commission or the Council.

Following the spirit of the Treaty of Rome, the Court has extended to trade in services (in five rulings on insurance and telecommunications), the two basic principles elaborated for trade in goods in the famous 1978 Cassis de Dijon case. In this ruling, the Court stated that EC Member States should not erect trade barriers between themselves on products which were produced and sold in accordance with the laws of one EC Member State. This statement is clearly similar to the one described above as the liberalization (mutual recognition) principle of the SMPS. At the same time, the Court envisaged the possibility of limiting the proclaimed freedom of trade in the name of 'imperative reasons relating to the public interest'. An EC Member State could erect trade barriers to a good sold in another EC Member State if the conditions of production and marketing in the exporting EC Member State could really harm 'confused' consumers in the importing EC Member State. When extending these principles to the case of 'mass risks' in insurance, the Court suggested that harmonization should reach a point where small policy-holders could not be confused about the real coverage offered by insurance products imported from another EC Member State. Far from being a set-back to intra-EC liberalization, as sometimes argued, the Court's rulings on insurance can be seen as a precious help for striking the right balance between liberalization and harmonization.[1]

Reciprocity and mimetism

At the world level, the *de facto* GATS discrimination between the various instruments of competition in services (modes of supply) limits the incentives for governments to compete in terms of regulation. Moreover, the absence of a world institution comparable to the European Court of Justice makes seminal rulings impossible. As a result, there are only two forces, reciprocity and mimetism, which can convey the message of competition between national regulations at the international level.

Reciprocity can be defined as the threshold of mutual concessions that trade partners consider necessary to sign a trade agreement. In cross-border trade in services, the principle of national treatment tends to relate reciprocity to home country rules. In the case of establishment-based international competition in services, reciprocity would instead refer to

[1] The 'general interest' principle will also be useful for solving disputes likely to emerge when enforcing mutual recognition and will require precise borders between licensing and operating rules. It will also be a powerful criterion for examining the impact of monopoly power.

host country rules. In practice, there is always a mixture of both rules.[1]

Is reciprocity likely to expand the SMPS approach in trade agreements which will involve the Community? The answer is mixed. Agreements concerning establishment-based liberalization are much less likely to lead to such a result. For service suppliers to obey host country rules may not be considered acceptable by both trading partners: the suppliers of the more regulated country may be seen as 'disadvantaged' relative to the service providers of the more liberal country, though there is no economic rationale for this proposition (indeed, consumers may prefer the more stringent rules).[2] These difficulties can be best illustrated by using the approach of Key and Scott (1991), who have built a matrix of cases corresponding to optimal combinations of policy goals and methods of providing services. They take into account five policy goals (competitive markets, safety and soundness, avoidance of systemic risks, deposit insurance and disclosure) and five methods of providing services (cross-border trade, entry and operations for both branches and subsidiaries). Out of the 19 cases in which a decision on host or home rules has to be made, 11 cases would be based on host rules (including the four cases where host rules should be accompanied by harmonization) and the rest 'on home rules (a very mixed result indeed)'.

Mimetism is another channel through which the SMPS could influence the rest of the world. The 1980s have already provided instances of unilateral liberalizations mimicking liberalizations previously undertaken in other countries.

In this context, the 1990s are likely to see cases where the SMPS acts as a source of inspiration, as suggested by the reform of the US regulations on banking. The initial intent of the reform of the US banking system was to introduce provisions relatively similar to the EC Banking and Investment Directives: i.e. adoption of uniform accounting standards, elimination of the branching restrictions which have imposed on many US banks an over-reliance on a single region and a few industries, elimination of the product restrictions which have frozen the US 'banks' in an increasingly narrow set of activities, elimination of free-riding problems raised by the system of the US Federal Deposit Insurance, and permission for new foreign banks to operate in the USA partly based on bank supervision in its home country. However, the final text adopted by the Congress fell short of these drastic changes, but it is worthwhile to underline that the resulting disappointment in the financial services industry has led to indications of the desire for minimal regulations. The expanding US Federal Deposit Insurance system has been perceived as one of the major sources of incentives for bankers to run poorly managed banks and to impose costs on tax-payers. More strikingly, it has been suggested that restructuring the US banking industry does not require new laws: banks which are members of the Federal Reserve system could get the flexibility and credibility they need by dissolving their parent holding companies and becoming State-chartered, non-Federal members, a solution which clearly relies on the idea of competition between the regulators of US States, one which may be more easily conceivable because of the EC situation.

5.2. Competition and services liberalization

The GATS adopts a neutral attitude in terms of market structures: monopolies and 'exclusive service providers' are recognized as legitimate market structures though the GATS takes into account the possible impact of monopolies on market access. In contrast, the whole SMPS exercise is based on the principle of competition in services. The seminal actions of the Court and the subsequent actions of the Commission in enforcing competition rules, and in carefully defining exemptions from them, reveal strong doubts about the possibility that competition can survive in the long run in sectors where monopolistic structures exist.

This focus on competition was initially supposed to raise a difficult problem. Is trade liberalization possible when trading partners have wide regulatory differences? This problem appears much less serious once the experience on trade liberalization in goods is considered. In contrast, the focus on competition reveals a problem which is relatively marginal in the case of manufacturing goods and which is much more serious in services than initially expected, namely, the sustainability of competition in services.

The enforcement of competition rules

The Treaty of Rome is based on two competition rules, Articles 85 on collusive practices and 86 on abuses of dominant position, which have been increasingly enforced in services, as shown in air transport. In 1986, the Court literally launched the SMPS with a ruling stating that EC competition rules apply to scheduled air transport in a case examin-

[1] The principle of 'comparable competitive opportunities' introduced by the EC Directives dealing with the relations between the Community and the rest of the world is based on reciprocity with a balance between host and home country rules and markets.

[2] The alternative principle of comparable competitive opportunities may not be more successful because it implicitly requires a comparison between the host and home country rules and markets.

ing allegations by Air France of price undercutting by the French tour operator Nouvelles Frontières. In April 1989, a second ruling *de facto* extended the scope of competition rules to routes between the Community and the rest of the world. The Court's ruling concerned 'abusive air fares' on the Frankfurt-Tokyo route. According to the International Air Transport Association (IATA) pricing rules, the fares Lisbon-Frankfurt-Tokyo were 60% less expensive than the direct Frankfurt-Tokyo fares. This was due to differences between market exchange rates and exchange rates used by IATA when setting the global network of European fares. An association 'for the campaign against unfair competition' backed by EC flag airlines lodged a complaint about unfair competition and price undercutting by two German travel agents who were selling Lisbon-Frankfurt-Tokyo fares. The Court stated that price-fixing agreements for flights between EC and non-EC airports fall under the scrutiny of Article 86, if they induce competitors to charge excessively high or low price fares on a single route. Moreover, the Court stated that airlines carrying out a task of 'general interest' (that is, flag carriers) are also subject to competition rules, so far as the application of such rules does not obstruct the performance of these particular tasks (a consequence of Article 90 philosophy).

Moreover, the Court has created a robust legal basis for the enforcement of Article 90 which states that public enterprises are not exempt from competition rules (embodied in Articles 85 and 86) except when they are performing their 'general interest' tasks. The procedure under Article 90 (available only if public firms that enjoy exclusive rights use them in a way that restrains competition) has been used by the Commission for adopting the Terminal Equipment Directive in order to overcome EC Member States' opposition and to ensure that the Directive would be ready on time for liberalizing telecommunications services *per se*.[1] Several EC Member States (France, Belgium, Germany, Greece and Italy) have brought a case in the Court contesting the Commission's use of Article 90. The Court confirmed that competitors to the telecommunications organizations (TOs) should be able to import, market, install and maintain telecommunications terminal equipment, and that independent regulatory bodies should handle approval responsibilities.[2]

Since the late 1980s, the Commission has imposed stricter enforcement of competition rules in a growing number of cases in banking, telecommunications, postal services, air and maritime transport, insurance and audiovisual services.

The Commission has also the power to grant 'exemptions' and 'block exemptions' from competition rules. For instance, after having received many notifications of potentially restrictive cooperation agreements in insurance, the Commission proposed rules for 'block exemptions' for agreements deemed to have net positive effects. In telecommunications, the Commission published a set of guidelines on the application of EC competition rules, such as the criteria which the Commission will use to evaluate the harmonization and coordination agreements between the TOs, the suppliers of new equipment, and the providers of new services in newly opened markets. The guidelines focus on justified restrictions of competition, the definition of the 'relevant' market, mergers and joint ventures, and the effect of international conventions. It is too early to assess the impact of all these exemptions. However, the unfortunate experience of the USA during the 1930s and 1940s, when service sectors were progressively exempted from competition laws, suggests that increasing attention should be devoted to these exemptions in order to check their economic foundations.

Services liberalization with wide regulatory differences

More open trade in services is likely to generate changes in the portfolio of activities (and strategies) of providers of services, as well as between services and goods. For instance, last year, British Railways stated its willingness to enter the British telecommunications market by both leasing lines and providing services; also, the Bell companies under strict regulations on their regional monopolies have moved to the production of sophisticated telecommunications equipment. These evolutions raise a general problem: can the changes

[1] A first Court ruling (on telex forwarding, in 1985) stated that government-sanctioned monopoly practices could conflict with Article 86 of the Treaty. Since the Terminal Equipment Directive, the Commission has used the Article 90 procedure twice, for liberalizing the Community's ECU 65 billion market of value-added services, and for requesting regulatory changes in the Dutch express-mail regulations (*Financial Times*, 9 January 1990).

[2] It is interesting to note that the Court did not follow the Advocate-General's conclusions (which stated that the Commission had exceeded its substantive competence by attempting to abolish the TOs' special and exclusive rights on importation, marketing, installation and maintenance of terminal equipment). In the same ruling, the Court annulled customers' rights to break anti-competitive long-term leasing contracts with the TOs, leaving open the possibility of prosecutions on a case-by-case basis for reaching this goal. The Court's approach in telecommunications can be compared to the approach taken by the European Parliament in insurance which has expressed reservations about the role of competition, and has suggested the creation of a 'code of good conduct' with a European supervisory body (two risky moves for competition).

mentioned above be more dramatic when the two trading partners have very different rules? Can countries having wide regulatory differences engage in services liberalization, or is there a need for 'special treatment'?

The SMPS approach, relying on similar rules between trade in goods and in services, leads to a clear answer: wide regulatory differences may raise the case for progressive liberalization, but not for 'special treatment' as illustrated by the longer time-spans granted to the less-developed Member States for adopting the Directives of the SMPS.

The approach favouring progressive liberalization over special treatment is based on two arguments. First, the more different the trade partners are, the larger the likely gains from trade. Wide regulatory differences may lead to divergences in differentiated competing services and hence generate large benefits in accordance with the golden rule on the gains from trade. In this case, each country will continue to provide a range of services, though trading partners may make important adjustment efforts for the remaining range of services (hence, the possibility of progressive liberalization in order to spread adjustment costs over a longer time-span).

Second, wide regulatory differences may reflect the fact that one of the trading partners is inefficient in the production of a relatively homogeneous service. In this case, imposing similar rules on trade in goods and services may lead to a marked specialization in services and goods, as illustrated by recent experiences in telecommunications' liberalization. Competing in telecommunications services has induced the TOs of the industrial countries to abandon their traditional production of basic equipment in order to concentrate on more attractive service markets (and their associated more sophisticated equipment), whereas newly available services have induced European consumers to demand more and cheaper equipment which could be more efficiently produced by developing countries. Table 76 provides results which suggest such an evolution in the case of telecommunications' liberalization. Developing countries have increased their market shares of the EC imports of telecommunications equipment by 20% (on average) during the first two new years following the beginning of liberalization in the three EC Member States observed. It is interesting to note that developing countries are trying to upgrade their products from basic phone sets to small phone terminals.

A difficult problem: 'sustaining' competition

It has been observed that deregulation of service industries may be followed by an increase in concentration, often after a period of decreased concentration. The role of public authorities in such cases is still hotly debated, in large part because the move towards concentration and its relationship with competition are still subject to scrutiny.

In any case, the Commission has felt it necessary to act 'in favour of competition', that is, to 'sustain' competition, as illustrated in air transport. Despite the Court's rulings mentioned above, and the two first liberalization packages, there have been little signs of increased competition. The coverage of multiple designation has increased from 5% of the scheduled air routes in June 1987 to 7% in June 1989, mainly because of the UK's policy. The coverage of the fifth freedom is even lower: one-fifth freedom service (out of 494 routes) was operated by a Community airline before 1988, and only eight in 1989. Another worrisome sign is that efforts to implement competition on routes under multiple designation basis have not been encouraging. Entrants are rapidly driven out of the markets or bought by the dominant (flag) carriers. Price collusion is frequent: following a recent British complaint on the United Kingdom-EC fares, the Commission has observed that 55% of the 88 examined air fares contravened the EC rule requiring that fares be related to costs. In sum, the EC airline industry emerging from the two first liberalization packages may already share certain aspects of the US airline industry: price discrimination and market power based on an integrated 'hub-and-spoke' system, where each hub tends to become monopoly disciplined, if at all, by spokes from other hubs.

Looking at the US example suggests that sustaining competition may have two components. It requires an 'economically-sound' definition of the service industry in question, which may be larger than the technical definition: airlines are services produced by aircraft and airports combined in time-schedules. It also implies a combination of domestic competition policy and international competition — it is likely that the US airline industry would be under more competitive pressures if competition on airports, reservation systems and domestic routes (by foreign carriers) had been more open.[1] As a result, if there are risks that sustaining competition could lead to excessive public intervention (through a too large a scope for intervention or a too heavy a domestic competition aspect) these risks are manageable by a careful examination of the cases.

[1] In its White Paper (June 1991), the Association of the European Airlines strongly supports measures with a clear non-competitive impact: reinforcing hub-and-spoke networks, not discriminating in favour of new entrants, and not hampering mergers, acquisitions and alliances.

Table 76

Imports of telecommunications equipment, 1980-88

Importing countries	Year of liberalization	Imports from LDCs			Imports from Japan		
		Import shares		Growth rate (%)	Import shares		Growth rate (%)
		Before	After		Before	After	
				Line equipment (SITC 7641)			
USA	1984	23,6	29,3	24,2	45,7	48,0	5,0
Japan	1987	19,3	33,2	72,3	—	—	—
EC 12							
UK	1983	3,2	11,1	245,9	13,2	28,9	119,3
France	1987	7,3	8,2	13,2	10,1	26,8	165,8
Germany	1988	6,6	8,8	32,9	27,5	58,9	113,8
				Transmitters (SITC 7643)			
USA	1984	51,6	51,0	−1,3	36,0	38,3	6,4
Japan	1987	8,4	29,7	252,8	—	—	—
EC 12							
UK	1983	12,0	3,9	−67,3	14,7	19,9	35,4
France	1987	9,5	9,9	4,0	14,1	7,5	−46,8
Germany	1988	13,2	13,6	3,2	24,5	17,3	−29,4
				Receivers (SITC 76481)			
USA	1984	46,0	47,6	3,5	52,5	48,2	−8,3
Japan	1987	4,7	7,2	52,7	—	—	—
EC 12							
UK	1983	1,9	3,7	93,1	10,2	23,9	134,0
France	1987	1,0	0,4	−57,2	16,4	18,4	12,0
Germany	1988	0,4	1,2	201,0	10,6	10,0	−5,5
				Line equipment parts (SITC 76491)			
Japan	1987	6,1	16,6	171,1	—	—	—
EC 12							
UK	1983	0,5	1,6	230,3	1,2	4,4	272,4
France	1987	1,1	7,3	553,0	10,5	27,5	162,8
Germany	1988	0,2	1,1	505,5	5,8	7,4	28,1

Sources: TARS system, ICC; author's computations.

6. Conclusion

Over the last decade, the importance of services in international trade relations has increased dramatically due to the growing awareness of the contribution of this large proportion of productive sectors to domestic growth and welfare and of the gains that certain countries have made by starting to open up their national markets. Since the mid-1980s, the Community has taken a pivotal role in this evolution. The single market programme in services has given the Community credibility as a potential major trading partner in services and an unsurpassed experience in terms of opening domestic service markets. Meanwhile, the Community has evolved from a cautious attitude towards the introduction of trade liberalization in services in the Uruguay Round agenda to a staunch supporter of the general agreement on trade in services.

The decline in measures restricting all kinds of competition in services, from cross-border to establishment-based trade, will place domestic production patterns in services under increasing pressures for adjustment and innovation. This evolution is already perceptible not only in the Community, but also in Western Europe as a result of the single market programme in services. Being a driving force for change in one of the largest services markets in the world, the single market programme in services will exert constant pressures for additional commitments on the Community and its trading partners within the framework of the general agreement on trade in services.

References

Bhagwati, J. N. (1984) 'Splintering and disembodiment of services and developing nations' *The World Economy*, pp. 133-144.

Burgess, D. F. (1990) 'Services as intermediate goods: the issue of trade liberalization', in Jones, R. W. and Krueger, A. O. (eds), *The political economy of international trade*, Basil Blackwell.

Cho, Y. J. (1988) 'Some policy lessons from the opening of the Korean insurance market', *The World Bank Economic Review*, pp. 239-254.

Coalition of Service Industries. (1991) *The Uruguay Round services negotiations: offers at a glance*, August, Coalition of Service Industries, Washington.

Commission of the EC. (1990) 'US trade barriers and unfair trade practices'.

Crandall, R. W. (1990) 'Entry, divestiture and the continuation of economic regulations in the US telecommunications sector', in Majone, G. (ed.), *Deregulation or reregulation? Regulatory reform in Europe and the United States*, Pinter Publishers.

Deardorff, A. V. (1985) 'Comparative advantages and international trade in services', in Stern, R. M. (ed.), *Trade and investment in services: Canada-US perspectives*, University of Toronto Press for the Ontario Economic Council.

Eurostat. (1991) *International trade in services (1979-98)*, Statistical Document D6, EC Official Publications.

Grossman, G. and Horn, H. (1988) 'Infant-industry protection reconsidered: the case of informational barriers to entry', *The Quarterly Journal of Economics*, November, pp. 767-787.

Hindley, B. (1987) 'Trade in services within the European Community', in Giersch, H. (ed.), *Free trade in the world economy*, J. C. B. Mohr.

Hindley, B. and Smith, A. (1984) 'Comparative advantage and trade in services', *The World Economy*, pp. 369-390.

Hoekman, B. (1990) 'Services-related production, employment, trade and factor movements', in Messerlin, P. A. and Sauvant, K. (eds), *The Uruguay Round: services in the world economy*, The World Bank and the UNCTC.

Hoekman, B. (1991) 'Multilateral liberalization of trade in services', University of Michigan Conference on Analytical and Negotiating Issues in the Global Trading System, mimeo, November.

Hoekman, B. (1992) 'Market access and multilateral trade agreements: the Uruguay Round services negotiations', NBER Conference on The Political Economy of International Market Access, mimeo, January.

Jones, R. W. (1985) 'A comment on comparative advantages and international trade in services', in Stern, R. M. (ed.), *Trade and investment in services: Canada-US perspectives*, University of Toronto Press for the Ontario Economic Council.

Jones, R. W. and Kierzkowski, H. (1989) 'The role of services in production and international trade: a theoretical framework', in Jones, R. W. and Krueger, A. O. (eds), *The political economy of international trade*, Basil Blackwell.

Kasper, D. M. (1988) *Liberalizing international trade in air services*, The American Enterprise Institute, Ballinger.

Kay, J. and Vickers, J. (1990) 'Regulatory reform: an appraisal', in Majone, G. (ed.), *Deregulation or reregulation? Regulatory reform in Europe and the United States*, Pinter Publishers.

Key, S. J. and Scott, H. S. (1991) 'International trade in banking services: a conceptual framework', *Group of Thirty*, Washington.

Lazar, F. (1990) 'Services and the GATT: US motives and a blueprint for negotiations', *Journal of World Trade*, February, pp. 135-145.

Messerlin, P. A. (1990) 'The European Community' in Messerlin, P. A. and Sauvant, K. (eds), *The Uruguay Round: services in the world economy*, The World Bank and the UNCTC.

OECD. (1985) *Monthly statistics of foreign trade (Series A)*.

Sampson, G. and Snape, R. (1985) 'Identifying the issues in trade in services', *The World Economy*, pp. 171-182.

Sapir, A. (1991) 'From fragmentation to restructuring of service markets in the European Community', Free University of Brussels and CEPR, mimeo, November.

Sapir, A. and Lutz, E. (1981) 'Trade in services: economic determinants and development-related issues', World Bank Staff Working Paper, No 474, The World Bank.

Sapir, A. and Winter, C. (1991) 'Services trade', in Greenaway, D. and Winters, L. A. (eds), *Surveys in international trade*, forthcoming.

UNCTC. (1988), *Transnational corporations in world development: trends and prospects*, New York.

USTR. (1985), *Selected problems encountered by US services industries in trade in services*, Washington, DC, processed.

White, L. J. (1988), *International trade in ocean shipping services: the US and the world*, Cambridge, Mass., Ballinger for the American Enterprise Institute.

Annex: Indicative list of service industries used in GATS offers

Business services
- *Professional services*
  - Legal services
  - Accounting, auditing, bookkeeping
  - Taxation services
  - Architectural services
  - Engineering services
  - Integrated engineering
  - Urban planning
  - Medical and dental services
  - Veterinary services
  - Other health-related services
  - Other
- *Computer-related services*
  - Consultancy on installation
  - Software implementation
  - Data processing
  - Database
  - Other
- *R&D services*
  - R&D on natural sciences
  - R&D on social sciences
- *Real estate services*
  - Real estate (own/leased)
  - Real estate (fee/contract)
- *Rental/leasing without crew*
  - Relating to ships
  - Relating to aircraft
  - Relating to other transport
  - Relating to others
- *Other business services*
  - Advertising services
  - Franchising
  - Market research
  - Management consulting
  - Services relating to management consultancy
  - Technical testing
  - Services relating to agriculture
  - Services relating to fishing
  - Services relating to mining
  - Placement and supply personnel
  - Investigation and security
  - Related scientific consultancy
  - Installation and assembly work
  - Repair of equipment, vessels, etc.
  - Building-cleaning services
  - Photographic services
  - Packaging services
  - Translation services
  - Sewage and refuse disposal
  - Printing, publishing
  - Other

Communication services
- *Postal services*
- *Courier services*
- *Telecommunications services*
  - Voice telephone
  - Packet-switched data transmission
  - Circuit-switched data transmission
  - Telex
  - Telegraph
  - Facsimile
  - Private leased circuit
  - Electronic mail
  - Voice mail
  - On-line information retrieval
  - Electronic data interchange (EDI)
  - Enhanced facsimile
  - Code and protocol conversion
  - On-line information and/or data processing
  - Other
- *Audiovisual services*
  - Motion picture and video tape production and distribution
  - Motion picture projection
  - Radio and television
  - Sound recording
  - Other
- *Other communication services*
  - News and press agency
  - Libraries and archives
  - Other

Construction and related engineering services
- *Project planning*
- *Feasibility studies*
- *General construction for buildings*
- *General construction for civil engineering*
- *Installation and assembly work*
- *Building completion*
- *Maintenance and repair*
- *Other*

Distribution services
- *Commission agents' services*
- *Wholesale trade services*
- *Food retailing services*
- *Non-food retailing services*

Educational services

Environmental services

Financial services
- *All insurance*
  - Life
  - Non-life
  - Reinsurance
  - Auxiliary services

Banking
Acceptance of deposits
Lending
Financial leasing
All payment
Guarantees and commitment
Trading
Participation in issues
Money broking
Asset management
Settlement and clearing
Advisory
Provision and transfer
Health-related services
Tourism, travel
Hotels and restaurants
Travel agencies and tour operators
Tourist guides
Entertainment services
Sporting and recreational
Other
Transport services
International maritime
Passenger
Freight
Rentals
Maintenance
Supporting services
Internal waterways
Passenger
Freight
Rentals
Maintenance
Pushing and towing
Supporting services
International air
Passenger
Freight
Rentals
Maintenance
Supporting services
Space transport
International rail
Passenger
Freight
Pushing and towing
Maintenance
Supporting services
Internal rail
Passenger
Freight
Pushing and towing
Maintenance
Supporting services
International road
Passenger
Freight
Rentals
Maintenance
Supporting services
Internal road
Passenger
Freight
Rentals
Maintenance
Supporting services
Pipeline
Transport of fuels
Other
Services auxiliary to transport
Cargo-handling
Storage and warehouse
Freight transport agencies
Other
Other transport services
Other services not included elsewhere

III — Trade-related intellectual property rights

Keith E. Maskus

Department of Economics,
University of Colorado at Boulder, USA

Summary

1. Trade in intellectual property has increased rapidly in recent years both through its embodiment in goods and through flows of foreign direct investment and licences for the use of technologies and trade names. Firms in the European Community are prominently involved in this trade, both inside and outside the Community.

2. This growth reflects, in part, the increasing globalization of business competition as firms employ sophisticated forms of international activity to exploit the economic value inherent in their innovative and creative work. Again, this form of competition is pronounced in the Community, especially as firms prepare for the unified market.

3. In this environment, government measures to protect intellectual property rights with patents, trade marks, copyrights and related devices take on greater importance as part of the background rules governing international trade and investment.

4. In general terms, the European Community has two broad interests in the intellectual property area. First, it is important to establish greater harmonization of national policies among the Member States in order to rationalize incentives for engaging in innovative activity and product marketing. Second, continued efforts need to be made through the GATT and other multilateral organizations to achieve stronger protection for intellectual property outside the Community, particularly in developing countries.

5. It must be recognized, however, that stronger levels of intellectual property protection carry certain costs as well as benefits. The essential reason for this tradeoff is that such protection attempts to overcome the dynamic economic problem that infringement limits the returns to innovation, resulting in an underinvestment in new technology and product development. In doing so, however, protection worsens the static economic problem that new information should be provided to users at marginal cost, which is likely to be too low to compensate innovators fully. Thus, intellectual property protection is inherently a crude solution to problems of a 'second-best' nature and changes in policy could, in principle, raise or lower welfare. Each package needs to be evaluated on a case-by-case basis.

6. In this context, technologically advanced countries with high-income consumers that have a strong preference for great product variety and quality achieve significant dynamic benefits from intellectual property protection. However, even in countries that should gain overall, there is a risk that stronger intellectual property protection could result in high costs for consumers and input users, and limited competition and technology diffusion. That is why there is a need for an effective competition policy to offset unwarranted abuses of stronger intellectual property rights.

7. In the multilateral context, a balance of advantages for movements toward global harmonization of IPRs could appropriately come from a comprehensive agreement in the Uruguay Round that guarantees greater access to markets in the developed countries for products in which developing nations have a clear export advantage.

1. Introduction and outline

It is important for this trade report to evaluate questions involving the links between international trade in goods and intellectual property rights (IPRs). Trade in intellectual property, the name for assets generated through industrial or commercial innovation and artistic creation, has grown rapidly both through its embodiment in goods and through flows of foreign direct investment (FDI) and licences for the use of technologies and trade names. As creators and consumers of intellectual property, firms in the EC are keenly interested in arrangements for such trade, both within and outside the Community. Further, as economic integration unfolds in the EC there is likely to be accelerated competition based on innovative activity and the control of valuable information. Accordingly, policy issues covering IPRs, including pressures for the international harmonization of regulations and the relationships to investment and competition policy, require careful consideration.

Briefly, IPRs are the protective mechanisms used to safeguard the rights of creative interests to exploit the economic value in their inventions. These policies include patents, trade marks, industrial designs, trade secrets, copyrights and neighbouring rights, and various hybrid devices for use in specific circumstances.[1]

During the 1980s there was a dramatic rise in concern about the forms of protection afforded IPRs by various nations and the effects that such protection may have on international trade, investment and technology transfer. Among the reasons for this concern, three loom as most significant. First, expanding globalization of industrial competition has induced firms to look for greater strategic advantages in setting international production and sales plans. Strong intellectual property protection may provide such advantages. Second, the growing ease and quality with which creative products may be copied has generated alarm over sales and profits lost to unauthorized duplication. Finally, the increasing commercial importance of new forms of technology and information, such as semiconductor devices and biotechnological products, the protection of which under

[1] Annex 1 to this paper provides detailed definitions of IPRs and circumstances under which they are used.

traditional IPRs may be ineffective or controversial, has led to a re-examination of the suitability of existing intellectual property regimes.

This interest in intellectual property has elevated IPRs to a high-priority status in bilateral and multilateral negotiations over international commercial policy. The EC has played a crucial role by strongly asserting its interests in the GATT. Moreover, the EC continues to move toward greater harmonization of IPRs among its members, consonant with the formation of a unified market. Any substantive changes in international levels of protection for intellectual property will have fundamental impacts on business competition and economic welfare. Whereas the liberalization of direct barriers to trade, such as tariffs and quotas, may strongly be presumed to improve welfare in both the liberalizing countries and the rest of the world, greater international protection (including harmonization of such protection) for intellectual property should result in a complicated set of benefits and costs that may be unevenly distributed across nations. These effects should further be distinguished as either static or dynamic in nature, in that greater protection may be expected to promote more rapid growth and innovation with global benefits.

The main aim of this report is to provide an economic assessment of this trend toward enhanced protection of IPRs. It will be argued that there is little evidence on which to reach firm conclusions about the extent of potential welfare impacts. None the less, it is important to understand the various tradeoffs inherent in such changes in policy in order to evaluate their desirability in general terms.

The report is organized as follows. In Section 2 information is presented on recent trends and directions of trade in intellectual property, with emphasis on the EC. There is also a brief characterization of the current situation regarding international protective regimes. Section 3 contains a detailed discussion of the economic arguments regarding the social costs and benefits of providing IPRs and a review of the limited evidence available on how well social objectives have been met. Concluding comments in Section 4 consider a basic framework for IPR policy in the Community. The primary issues include negotiations over IPRs outside the EC, harmonization within the unified market, and the relationship between intellectual property protection and the need for an active competition policy.

2. Trends in intellectual property trade

A firm's ability to appropriate returns to innovative activity is enhanced by a judicious choice of its global marketing strategies. In general, there are three means by which intellectual property may be traded. The first mechanism is simply to engage in international exchange in goods that embody a creative component. To some extent the value of such trade reflects the inherent economic benefits of the embodied information. A second choice is to undertake foreign direct investment to establish various production locations. Among the reasons that could motivate this choice is the fact that firms may see greater opportunity to safeguard their proprietary informational advantages through FDI. Finally, firms may trade their intellectual property directly by licensing rights to use it in return for negotiated royalty payments. Although it is impossible to ascertain the precise values of these various forms of trade in intellectual property, it is worth while to consider the available evidence on trends and patterns.

2.1. Trade in goods embodying intellectual property

One major reason for the current interest in IPRs is that international trade in intellectual-property-intensive (IPI) goods is an important part of trade for many countries. Perspective on this issue is provided in Table 77, which shows the percentage growth in total exports and imports for the EC-12 countries, EFTA, the United States, Japan, and three developing nations between 1985 and 1989 and for trade in aggregations of selected manufactured IPI goods.[1] It should be noted that these figures are expressed in terms of US dollars. Were they expressed in ecus, the percentage changes would be considerably less. These goods are grouped into categories that tend to face serious problems of foreign infringement of patents, trade marks and copyrights, respectively. These categories do not include all IPI goods, nor even necessarily the most important ones, largely because services are excluded. For example, the group of copyright goods comprises only printed matter and sound recording media, with no consideration for the value of international broadcasts. The selection of goods here reflects their significance in current international disputes over IPRs.

Also listed are exports of these grouped goods as a share of total merchandise exports in 1989, as a basic indication of the relative advantages of different countries in producing IPI goods. Further, estimates of the amount of each EC Member State's exports of these goods to places outside the

[1] See Annex 2 for a classification of the goods included.

Community as a share of national extra-EC exports are presented. Comparisons of these two columns provide an indication of how intensively the member countries export these goods to non-EC sources relative to their overall trade in IPI goods. Finally, for each country an estimate of the 1989 trade balance (in millions of US dollars) by type of good (including, for EC members, trade both within and outside the Community) is included. Note that positive or negative trade balances in various groups of goods in a particular year should not be taken as literal measures of comparative advantage, because such trade balances are largely driven by national macroeconomic conditions.

Trade figures for the Republic of Korea, Brazil and India are included because these are important countries at varying levels of industrialization and technological development. These nations also have been strongly criticized for their weak intellectual property laws.

Recognize that values of international trade flows reflect many influences and it is not possible to estimate separately the effect of intellectual property pricing and protection. For example, trade in both inputs and outputs is often carried out within multinational enterprises (MNEs). Thus, internal prices may have little relation to the economic value of the intellectual property embodied in goods.[1] For such reasons, trade data present only a broad picture of implicit international transactions in intellectual assets.

Given these caveats, note in Table 77, Panel A, that the late 1980s saw 76% increases in overall merchandise imports and exports for the EC-12 countries. Spain and Portugal experienced particularly rapid increases in trade. However, gross trade (both within and outside the EC) in goods for which patents are important forms of protection (largely chemicals, pharmaceuticals, certain machinery, semiconductors, and precision instruments) rose somewhat less, especially on the export side, as shown in Panel B. Only Belgium-Luxembourg displayed near-balanced growth in both imports and exports in these products. In contrast, except for India, countries outside Europe enjoyed relatively larger increases in trade in patent goods than in overall trade, with an especially rapid rise in Korean exports. India's exports actually declined in nominal terms.

Despite the slower growth in exports, patent goods constituted a significant share of total exports and extra-EC exports for many Member States in 1989, accounting for 8,1% of the UK's total exports, for example. Remarkable in this context is Ireland, which exported a disproportionately high value of automatic data-processing equipment. Most of these exports were assembled and shipped to EC partners and other countries under licence to foreign firms. This fact points out that the data in Table 77 do not imply that firms in the exporting country necessarily own the relevant patents. Germany and the Netherlands also had high export shares in patent goods in 1989. Patent goods loomed somewhat larger in German extra-EC exports than in total exports, reflecting Germany's strong competitiveness in supplying world markets with them. This situation also characterized the UK, France and Denmark. Spain, Portugal and Greece exhibited smaller export proportions in patent goods, which are not yet areas of comparative advantage for them.

Although the data are not shown, the nominal values of trade were large. For example, in 1989 Germany exported USD 27,2 billion in patent goods overall, with some USD 13,3 billion going outside the EC. Imports and exports for the EC-12 in these goods totalled USD 162,6 billion in 1989, with an external trade deficit of USD 3,8 billion. If infringement caused total trade flows to be distorted by as little as 2% in 1989, EC firms in these industries lost perhaps USD 3,3 billion in sales.[2] The main IPR interest of innovative firms in Germany and elsewhere would be strengthened foreign patents to prevent unauthorized duplication and sales of new products and processes.

The United States and Japan stand out among the other countries as strong exporters of patent goods, while Korea is rapidly expanding its relative advantage as well, primarily in automatic data-processing equipment and semiconductors. In contrast, Brazilian and Indian exports have stagnated in relative terms. The figures for India suggest that, in general, the poorer developing nations have strong comparative disadvantages in the development of new technologies and products.[3] These countries are concerned that a tightening of their intellectual property laws would result only in higher import prices with little offsetting benefits in terms of induced innovation and technology transfers.

As shown in Panel C, trade by Member States in selected goods in which trade mark protection is prominent (alcoholic beverages, cosmetics, glassware, automobile parts, furniture, luggage, clothing, watches and toys) grew more rapidly than overall trade. Starting from a small base, Spain,

[1] See Maskus (1990) for further discussion.

[2] Feinberg and Rousslang (1990) report that US firms claim infringing sales ranging from 2,8 to 14,3% of global sales in IPI-intensive goods. No comparable claims exist for EC firms. Note, however, that since the gross trade data discussed here include much exchange among EC Member States, wherein IPRs are more strongly protected than in many other areas of the world, such damages are likely to be slighter than indicated.

[3] This point is shown clearly in the case of Africa, as detailed by Maskus (1990).

Table 77

Growth in international trade in total and in selected intellectual-property-intensive goods, 1985-89[1]

Country	Growth in imports (%)	Growth in exports (%)	1989 export share[2]	1989 extra-EC export share[3]	1989 TB[4]
		Panel A — Trade in total merchandise			
EC-12	75,8	75,8	100,0	100,0	−32 783
Belgium-Luxembourg	77,4	88,4	100,0	100,0	1 587
Denmark	50,9	71,0	100,0	100,0	1 417
Federal Republic of Germany	70,2	86,1	100,0	100,0	72 489
Greece	59,0	66,1	100,0	100,0	−8 583
Spain	130,4	77,1	100,0	100,0	−26 962
France	78,5	83,2	100,0	100,0	−13 638
Ireland	73,9	99,6	100,0	100,0	3 258
Italy	68,0	75,4	100,0	100,0	−14 410
Netherlands	59,9	58,0	100,0	100,0	3 611
Portugal	144,7	124,1	100,0	100,0	−6 271
UK	81,0	50,3	100,0	100,0	−45 281
EFTA	68,9	70,9	100,0	—	1 629
USA	36,4	66,3	100,0	—	−129 383
Japan	62,8	56,6	100,0	—	64 333
Korea	97,4	106,0	100,0	—	927
Brazil	39,0	34,1	100,0	—	16 111
India	27,9	79,2	100,0	—	−4 256
		Panel B — Trade in goods with potential patent problems			
EC-12	77,8	51,4	7,1	7,4	−3 783
Belgium-Luxembourg	74,0	69,6	5,5	5,1	110
Denmark	47,6	41,6	5,6	6,4	−630
Federal Republic of Germany	76,1	51,6	7,9	8,7	7 506
Greece	41,0	30,8	1,1	0,3	−576
Spain	88,5	28,1	4,1	5,1	−1 546
France	75,6	56,2	5,7	6,4	−3 094
Ireland	94,1	57,0	13,8	12,5	1 213
Italy	92,6	36,0	6,6	6,5	−2 543
Netherlands	117,9	70,7	7,7	6,6	−1 269
Portugal	114,0	41,3	2,7	3,2	−662
UK	56,0	46,0	8,1	8,5	−2 292
EFTA	52,3	40,9	6,7	—	−1 222
USA	75,4	81,6	10,5	—	1 900
Japan	104,5	98,9	13,2	—	26 500
Korea	149,4	308,6	10,1	—	1 155
Brazil	169,7	73,8	3,9	—	−446
India	34,7	−27,8	1,1	—	−1 598

Table 77 (Continued)

Country	Growth in imports (%)	Growth in exports (%)	1989 export share[2]	1989 extra-EC export share[3]	1989 TB[4]
		Panel C — Trade in goods with potential trade mark problems			
EC-12	100,5	75,2	8,3 (5,6)	8,0	3 752
Belgium-Luxembourg	30,4	87,8	4,8 (3,3)	2,6	−2 939
Denmark	59,8	51,7	7,6 (5,3)	10,9	237
Federal Republic of Germany	105,6	92,2	7,4 (5,8)	7,6	−847
Greece	266,9	127,5	21,0 (1,4)	15,4	594
Spain	257,8	90,4	7,7 (6,7)	9,5	−948
France	139,8	105,3	10,1 (8,0)	9,9	1 060
Ireland	74,3	54,5	4,5 (2,9)	3,5	− 213
Italy	124,1	78,0	14,7 (7,8)	12,9	13 851
Netherlands	90,3	82,3	3,4 (2,0)	1,6	−4 461
Portugal	1 005,9	135,8	25,0 (4,8)	26,9	1 795
UK	98,8	34,4	6,3 (4,7)	4,7	−6 584
EFTA	86,2	73,9	6,0 (4,8)	—	−6 295
USA	39,0	40,5	5,2 (4,6)	—	−37 647
Japan	246,0	58,9	4,9 (4,7)	—	1 528
Korea	187,7	98,1	18,2 (3,6)	—	10 547
Brazil	148,0	21,2	2,5 (1,8)	—	239
India	20,8	122,2	14,9 (1,5)	—	1 996
		Panel D — Trade in goods with potential copyright problems			
EC-12	115,3	84,8	0,8	0,9	397
Belgium-Luxembourg	89,7	81,3	0,5	0,3	−268
Denmark	69,9	88,4	0,9	0,9	34
Federal Republic of Germany	127,8	100,1	0,8	1,0	917
Greece	204,0	16,7	0,2	*	−62
Spain	222,1	−4,7	0,6	1,2	−132
France	116,0	68,8	0,6	0,8	−524
Ireland	86,0	444,4	4,9	2,9	832
Italy	134,1	40,7	0,4	0,3	−174
Netherlands	117,9	95,8	1,0	0,7	177
Portugal	292,6	71,4	0,2	*	−82
UK	76,9	47,7	1,1	1,3	−113
EFTA	94,2	84,8	0,4	—	−1 376
USA	31,7	123,2	1,1	—	1 347
Japan	101,9	14,3	0,8	—	1 451
Korea	151,6	233,9	1,3	—	672
Brazil	195,3	72,2	0,1	—	−96
India	76,9	0,0	0,1	—	−76

[1] See Annex 2 for a list of the goods included.
[2] Share of this type of product in total exports (figures in parentheses in trade mark goods exclude clothing).
[3] Share of estimated extra-EC exports of this type of product in total extra-EC exports.
[4] Trade balance in millions of US dollars.
* = too small to compute.

Source: UN, *Yearbook of International Trade Statistics.*

Portugal and Greece have seen particularly rapid rises in imports and exports of these goods. Such products were highly significant in the export patterns of France, Italy, Portugal and Greece. However, the two latter countries tend to be locations in which products are assembled under labour-intensive conditions and for which trade mark ownership largely resides elsewhere. This fact is seen from the low remaining export shares after clothing is removed from the sample. It is likely that over time firms in these countries will develop innovative clothing designs for which trade mark protection will be important.

As expected, Italy and France displayed clear advantages in designing and producing status goods, such as cosmetics, luggage and clothing, under trade mark. Innovative design houses have clear interests in greater foreign protection for their products and fashions. Germany's largest export strength lay in automobile parts, an industry for which trade mark protection is crucial for profitability. France and Italy also were strong exporters of automobile parts in 1989. Denmark's most prominent advantage was in exporting furniture under trade mark protection. The Netherlands, Belgium-Luxembourg and Ireland relied relatively little on exports of trade marked products.

Outside the Community, Japan (in automobile parts) and Korea and India (in toys and clothing) demonstrated relative advantages as indicated by associated trade surpluses. The United States remained the largest single trader of these commodities, but imports far exceeded exports. Of course, much of these imports were of goods with US and foreign trade marks produced abroad under licence. Thus, despite the apparent comparative disadvantage at the production stage, American and European firms largely retain their design functions at home. Again, these sectors would benefit from stronger foreign IPRs to prevent unauthorized production and export of knock-offs.

Turning last to products with potential problems in copyright protection (printed materials and sound recordings and tapes), Community trade expanded relatively rapidly from 1985 to 1989. Comparatively large export shares were recorded by Germany, the United Kingdom, the Netherlands, Denmark and Ireland.[1] Ireland's strong export showing reflected large net exports in sound recordings in 1989. Spain demonstrated a relatively large share of copyright goods in its extra-EC exports.

Outside the EC, the United States, Japan and Korea have strong export shares in these goods. The situation in the latter two countries also arose due to substantial net exports of tapes and recordings. It should be noted that, while Korea has been the frequent subject of allegations about production and exports of counterfeit recordings, the data in Table 77, Panel D, reflect trade in products recognized as legitimate by Korean authorities. Thus, it appears that Korea has a growing interest in exporting copyrighted goods, perhaps under licence to foreign firms.

While international trade data present, at best, only rough indications of trade in intellectual property, some broad conclusions are warranted from this review. It appears that global markets for IPI goods have expanded rapidly and dynamically in recent years, leading to significant potential for infringement. These goods are substantive components of trade in the industrial countries, wherein the interests of innovative firms lie in stronger foreign protection. Further, for many countries trade in IPI products is distinctive in terms of comparative advantage or disadvantage. Thus, there is a clear difference in the interests of the industrial countries and the poorer developing nations regarding IPRs. Finally, rapidly industrializing countries, such as Korea, should prefer to see improved domestic and global protection as their economies become more dynamic technologically and consumer preferences shift more toward higher-quality products and services.

In the light of these factors, growing concern among innovative firms and trade policy authorities about global IPRs is readily understood. Firms are likely to experience substantial losses in sales, profits and employment due to domestic and foreign infringement of their intellectual assets, though it is difficult to assess how large these losses actually are. For example, respondents to a survey by the US International Trade Commission (1988) claimed a total of USD 9,3 billion in lost sales and exports in 1986. However, such claims surely overestimate actual damages, in part because stronger protection of their rights would call forth higher prices, diminishing overall sales. It is inappropriate to assume that new sales after the introduction of greater protection would just replace existing sales. Analysts would need information on market elasticities and market structure to predict future sales, a difficult prospect (Maskus, 1990). Further, firms that respond to such surveys may have an incentive to overstate their expected damages from deficient foreign IPRs. None the less, some innovative businesses and creative interests in the industrial countries surely would benefit from stronger international protection.

From a policy standpoint, the greater concern should be with potential damage to the trading system from differing

[1] Recall that the small export shares in these goods should not be interpreted to mean that copyrights are unimportant in EC international trade. Most transactions for which copyright protection is common, primarily in services, are excluded here. In general, the Community is a strong producer of copyrightable materials.

international levels of intellectual property protection. Unquestionably, the form and enforcement of IPRs can distort trade and reduce the efficiency of global markets. The nature of these distortions may be subtle, however. On the one hand, border protections may be so stringent that they present an unwarranted barrier to trade and provide excessive monopoly power to home-market firms. This is a continuing worry in the EC, as care is taken to ensure that national IPR regimes do not interfere with the free internal flow of goods as called for in the Treaty of Rome. The problem is more acute in some developing countries, where limited or discriminatory protection may act as a non-tariff barrier to imports by encouraging local firms to imitate a foreign product and exclude imports of the original good by procuring and exercising its own patent or trade mark.[1] More generally, unauthorized production may displace imports of the original good in home and third-country markets. On the other hand, lower levels of protection for intellectual property could expand trade by indirectly subsidizing exports of infringing products. It could also induce greater exports of legitimate goods from innovative firms if they find it strategically more advantageous to serve markets with exports, rather than licensing technology to local firms. The latter decision might more readily risk the unauthorized loss of proprietary information in a poorly protected country.

Thus, in principle, different levels of IPRs could expand or reduce trade. The only systematic evidence on this question lies in a recent study by Maskus and Eby-Konan (1992), in which econometric models of equilibrium bilateral trade flows are estimated. The residuals from these equations are then related to variables that might explain the existence of disequilibria in international trade. One variable is an index of the strength of patent protection across countries at various levels of economic development. While the evidence is still rather preliminary, it suggests that bilateral trade is detectably diminished from its expected levels by weak patent regimes. In consequence, stronger levels of protection in developing nations would tend to shift global trade more toward those markets.

2.2. Investment and technology transfer

While trade in merchandise is an important means of ensuring adequate returns to innovative activity, firms also earn foreign income by establishing subsidiaries in which production of IPI goods takes place. The parent corporation receives licence fees and investment income from its foreign affiliates. Additionally, intellectual property assets may be exploited through licensing of technologies, industrial secrets, and brand names to unaffiliated firms. This process involves selling or renting rights to produce and distribute goods under trade mark or copyright. The choice between FDI and licensing is complex and depends on a variety of strategic factors.[2] This subsection considers simple evidence on trends in both forms of trade.

Note that neither type of exchange is readily measurable. Recorded intra-firm transactions are likely to be distorted to reduce global tax liabilities. Royalties and fees paid depend on government restrictions on foreign remittances and other policies. Optimal pricing of information is itself a complex problem for firms to solve, so receipts of licence fees and investment income inherently may be inadequate measures of the economic value of intellectual property.

Again, however, it is interesting to examine the limited data available.[3] Table 78 presents information on the levels of, and growth in, the foreign direct investment positions of EC Member States and other countries in recent years, along with the balances on direct investment income. Direct investment income is typically defined as reinvested earnings on direct investments plus dividends, interest, and remittances. For Community Member States the stocks of FDI listed include both investment within and outside the EC. The bulk of this investment is intra-EC. It is clear that the value of foreign-owned capital stocks in this set of nations increased markedly in the late 1980s.[4] Most of the global expansion in investment has been within the industrial countries as part of the trend toward more interdependent competition.

[1] This was one function of the Brazilian informatics policy, which is undergoing reform.

[2] Horstmann and Markusen (1987) provide an example of this huge literature.

[3] See the paper by Professor Greenaway in this volume for additional data on trends in FDI concerning the Community.

[4] These figures are in billions of nominal US dollars, so part of the increase is associated with depreciation of the dollar over this period.

Table 78

Foreign direct investment positions and balances on direct investment income and other property income, 1990; and growth in foreign direct investment positions, 1985-90

Country	FDI position[1]				Balance on FDI income[2]	Balance on other property income[3]
	Source	Growth (%)	Host	Growth (%)		
Belgium-Luxembourg (1989)	15,8	267,4[4]	21,9	163,9[4]	n.a.	−0,2
Federal Republic of Germany	132,7	211,5	53,5	134,6	−0,3	−1,9
Greece	n.a.	n.a.	n.a.	n.a.	−0,1[6]	−0,02
Spain (1988)	6,1	85,8[5]	33,6	257,4[5]	−1,9[6]	−0,9
France (1988)	45,2	n.a.	n.a.	n.a.	n.a.	−1,1
Italy	60,0	233,3	60,0	200,0	n.a.	−1,2
Netherlands (1989)	87,3	83,4[4]	55,0	121,8[4]	2,7	−0,7
Portugal	0,1	400,0	2,1	600,0	−0,3[7]	−0,1
UK	244,8	141,9	205,6	228,4	19,0	−0,1
USA	598,1	57,6	465,9	105,1	52,7	12,7
Japan	201,4	357,7	9,9	110,6	2,6[6]	−3,6
Korea	2,1	320,0	4,8	220,0	−0,2[6]	−0,1
Brazil	n.a.	n.a.	n.a.	n.a.	−2,4[6]	−0,1
India (1988)	n.a.	n.a.	n.a.	n.a.	n.a.	−0,1

[1] End-of-year (net), in billions of US dollars.
[2] Reinvested earnings on direct investments plus dividends, interest, and remittances, in billions of US dollars.
[3] Net receipts minus net payments of royalties and fees for all property, in billions of US dollars.
[4] Growth from 1985-89.
[5] Growth from 1984-88.
[6] Direct investment income excludes reinvested earnings.
[7] Balance on direct investment income estimated by author. Data on Denmark and Ireland are unavailable.

Source: International Monetary Fund, *Balance of Payments Statistics Yearbook*, 1990.

Among EC members, the UK, Germany and the Netherlands stand out as net providers of foreign investment, though all three countries have seen rising inflows of foreign capital as well. In relation to the size of its economy, Germany remained host to a small stock of foreign capital in 1990. Italy had a balanced position in terms of its net ownership. Italy, Belgium-Luxembourg and Portugal have been the source of especially rapid increases in foreign capital stocks, albeit from a small base in the case of Portugal. Spain and Portugal enjoyed dramatic percentage increases in the value of foreign-owned capital in their economies, presumably in response to their accession to the EC.

Firms have numerous reasons for expanding direct investments abroad. Though it is not possible to sort out these factors with the limited data in Table 78, surely some portion of these investments represents attempts to expand returns to innovation and product development. Using the measures listed here, in 1990 the UK owned the world's second largest stock of direct foreign capital at USD 245 billion, and earned USD 19 billion in direct investment income on balance in 1990. The Netherlands also earned positive net income on its foreign investments in 1989. Germany had a slightly negative balance on direct investment income, despite owning a larger stock of foreign capital than was owned in that country. Though there is limited evidence on this question, other Member States tended also to have negative balances on FDI income. It should be noted that these net figures do not indicate well the importance of gross income from FDI across nations. Germany, for example, earned approxi-

mately USD 5 billion in private foreign direct investment income in 1989 while the UK received almost USD 28 billion. The Netherlands earned over USD 4 billion and France nearly USD 1,5 billion exclusive of retained earnings.[1] Thus, this form of foreign income is significant in many EC States, suggesting the importance of taking active measures to safeguard the value of such investments, including intellectual property protection and the avoidance of inefficient trade-related investment measures.

The United States is both the largest source and largest host of foreign-owned capital stocks. In 1990 it remained a net source country, as was reflected in its net direct investment income of USD 52,7 billion. Japan is unusual among industrial countries in serving as recipient of so little FDI relative to what it provides. Korea, where incoming FDI from the industrial nations has increased rapidly, and Brazil make large net payments on direct investment income, as is to be expected for developing economies. Korea has also rapidly expanded its FDI abroad.

The final column in Table 78 presents a more direct measure of trade in intellectual property. The balance on other property income includes not only net receipts of royalties and licence fees for the use of trade marks, patents and copyrights, but also net receipts for tangible property, such as mineral rights. Thus, it is too inclusive as a measure of payments for intellectual property. It is the only direct measure available for the developing countries listed, however. The United States remained the only clear net recipient of such income in 1990, though the United Kingdom traditionally has been in that position. Other EC Member States make net payments for such properties, as does Japan. Clearly, the developing nations listed here are net importers of technology and the services of other properties.

A better measure of trade in technological assets exists for the OECD nations. Table 79 presents receipts, payments, and the difference between them, or the so-called 'balance on technology trade' for the EC nations, the United States and Japan in 1988 and the percentage increase in receipts and payments from 1984 to 1988. These transactions include royalties and licence fees for the use of technological information, such as patented processes and new products under patents and trade marks.

This measure suggests also that the trade of many EC Member States in intellectual property of a technological nature rose markedly in the late 1980s. Germany saw a greater than six-fold increase in its receipts, to some USD 3,9 billion. Despite this rise, Germany remained a net payer of such royalties and fees in 1988. Italy was in a similar situation, with its receipts rising considerably faster than its payments. These figures indicate that certain EC Member States are becoming more visible sources of new technologies and products of international interest. In US dollar terms, Portugal's receipts actually declined, though they were small in any case. Portugal and Greece also saw only small rises in their payments of licences and fees for foreign intellectual property.

Overall, EC countries typically had negative balances on technology trade in 1988, suggesting they remained net importers of industrial property.[2] For example, the UK had become a net payer by 1988, despite its traditional position as a net recipient. Spain stands out as a country to which technology has been transferred in this manner, with payments exceeding receipts by more than a factor of seven. Indeed, except for Denmark and Ireland, for which the available data are old and sketchy, EC Member States uniformly were in a deficit position on the technology balance of payments. Of course, this fact does not imply that Community members are worse off as a result of this trade. Rather, imports of foreign technology are a key means of expanding the technological base for competitive purposes.

According to the data in Table 79, the United States remained the major net global supplier of technology in 1988, though its payments have been rising faster than its receipts. Japan remained a large net payer for imported technology and trade marks.

As a final indicator of the growth in technology trade, statistics on patent applications in EC countries, the United States and Japan and on applications by residents of those countries elsewhere are presented in Table 80.[3] As may be expected, the countries of the Community found that the vast majority of applications were filed by foreign citizens in 1988, though much of this reflected patenting across EC nations. The share of foreign patent applications, as may be

[1] See International Monetary Fund, *Balance of Payments Statistics Yearbook*, 1990. These figures do not include income from foreign portfolio investments, which is substantially larger.

[2] It is impossible to ascertain whether the Community as a whole had a positive or negative balance, since these data are not reported on an intra-EC basis. Many of these transactions represent licensing activity across Member States.

[3] At best, patent application statistics are only rough measures of technology development and trade. For example, most applications are for minor modifications of existing technologies and products rather than for significant new developments of wide application. Further, many of the applications are made in several countries. Finally, the statistics reflect differences across countries in patent procedures that may encourage or discourage filing without reference to the underlying informational content of the application.

Table 79

Receipts, payments and balance of payments on technology trade, 1988; and growth in receipts and payments, 1984-88

Country	Receipts[1]	Payments[1]	Balance[1]	Growth in Receipts (%)	Growth in Payments (%)
Belgium	1 300	1 862	−562	121,1	163,4
Denmark (1985)[2]	217	190	27	102,8	167,6
Federal Republic of Germany	3 924	4 687	−763	648,9	366,4
Greece	n.a.	12	n.a.	n.a.	9,1
Spain	187	1 416	− 1 229	55,8	189,6
France	1 522	1 914	−392	84,5	107,8
Ireland (1983)	717	328	389	n.a.	n.a.
Italy	654	1 207	−553	336,0	136,2
Netherlands	518	951	−433	156,4	142,0
Portugal (1985)[2]	4	36	−32	−20,0	2,8
UK	1 896	2 068	−172	114,0	144,7
USA	10 858	2 054	8 804	106,1	184,1
Japan	1 956	2 480	−524	77,0	121,2

[1] Millions of US dollars.
[2] Growth from 1981-85 in dollar terms.
Source: Organization for Economic Cooperation and Development, *Basic Science and Technology Statistics*, 1991.

Table 80

Patent applications and percentage of foreign patent applications, 1988; external patent applications and share in US applications, 1988; and growth in patent applications, 1984-88

Country	Patent applications in country			External patent applications		
	Total	Growth %	% Foreign	Total	Growth %	% of US
Belgium	33 867	39,9	97,5	6 003	34,1	0,4
Denmark	11 080	38,5	89,2	7 639	102,8	0,4
Federal Republic of Germany	84 806	13,5	63,2	128 026	40,7	8,5
Greece	13 764	294,4	97,3	212	34,2	0,0
Spain	26 251	145,3	93,0	2 722	32,4	0,2
France	66 095	24,1	81,2	53 150	45,6	3,3
Ireland	3 901	15,7	81,4	939	78,5	0,1
Italy	52 939	47,8	61,7	25 271	64,6	1,4
Netherlands	40 115	55,0	93,6	20 433	46,6	1,1
Portugal	2 464	33,0	97,8	105	1 212,5	0,0
UK	79 916	21,2	75,2	54 926	54,2	4,0
USA	146 904	28,4	48,8	200 842	35,9	51,2
Japan	345 239	20,4	10,6	101 192	60,0	20,2

Source: Organization for Economic Cooperation and Development, *Basic Science and Technology Statistics*, 1991.

expected, was related to country size and technological base, with Germany, the UK and Italy having had the lowest such shares. In contrast, only 49% of US applications and 11% of Japanese applications were filed by foreigners. The Japanese result stemmed from an extraordinarily high propensity of Japanese firms to file for Japanese patents.

Most EC Member States experienced faster growth in residents' filing activity in other countries than in total applications at home, suggesting a rising tendency to procure protection abroad for innovations in preparation for their foreign marketing. In total, EC countries filed 19,4% of all US applications in 1988, with Germany, the UK and France accounting for the bulk of this activity. This may be compared with Japan's 20,2% share of US applications. At the same time, only German citizens filed more applications abroad than were filed at home. Greece presents the opposite situation, with far more foreign applications filed in Greece than Greek applications filed in foreign jurisdictions. In interpreting the results in Tables 78-80, the question of main interest regards the role that IPRs play in promoting foreign direct investment and technology transfer. A major argument on behalf of stronger protection in technology-importing nations is that it would induce greater inward flows of capital and productive knowledge, thereby expanding employment, skills, and growth (Rapp and Rozek, 1990, and Sherwood, 1991). First, firms would be more willing to share technologies with local affiliates and licensees when there are legal guarantees that these technologies cannot be imitated by domestic competitors. Second, strong international protection should expand the global character of an innovative firm's production and marketing decisions, since it need not concern itself with forestalling or disciplining infringement in different markets. For example, since trade marks protect international reputations, which are 'firm-specific assets', multinational enterprises are more likely to exploit their reputations through FDI than they would in the absence of strong IPRs (Horstmann and Markusen, 1987). Third, if they operate properly patents should directly increase international technology diffusion as details of applications are made public. Finally, FDI and technology flows could be indirectly encouraged if MNEs view the extension of new protection as a broader commitment by governments to establish private property rights and promote market mechanisms.[1]

There is surely substantial validity to these arguments, especially in the context of the European Community. A unified internal market requires substantive harmony in IPR policies in order to promote efficient internationalization of business among Member States.

However, given the complexities of FDI and technology trade, no unambiguous case can be made in general about the links between IPRs and such transactions. For example, it can be argued that MNEs may undertake greater FDI in countries with limited protection in order to maintain proprietary information within organizational control (Maskus, 1990). The extension of protection by such countries could alter strategic decisions in favour of licensing, exporting, or simply not 'working' the patent, with uncertain impacts on investment and technology transfer. Moreover, if a country's technological capabilities are insufficiently advanced to absorb and improve upon patented information, patents may serve to stifle diffusion, rather than promote it.

Thus, there again is a difficult empirical question on which there is little systematic evidence. Survey results (Mansfield, 1984) note the rising importance of intra-firm technology transfers and the internationalization of R&D. While no effort was made to relate these trends to industrial property policies, the latter presumably play some role in encouraging such transactions. That role may be limited, however. As suggested by Teece (1977), these decisions may depend more readily on the capacity of recipient countries to absorb and exploit technologies. In turn, this capacity depends on local market size and structure, and the dynamism, skill levels and managerial abilities of subsidiaries and licensees. Also significant are the costs of transferring technology, which may be little related to policies covering IPRs.

These factors help explain the fact that international transactions in investment and technology are dominated by flows among the industrial countries. In general, these countries also have the strongest protection for intellectual property. Casual empiricism, then, could support a strong relation between IPRs and technology trade that may be weaker in reality. Additional evidence on this question would be valuable.

2.3. International policy initiatives in intellectual property

It is clear from this brief description that intellectual property protection is undergoing a significant evolution to meet the needs of a more competitive and technologically dynamic world economy. Much of this change is occurring in the

[1] This signalling impact of IPRs is evidently behind recent moves by Mexico and certain Central European nations to strengthen their policy regimes.

developing countries, many of which have responded to various external pressures to strengthen their intellectual property regimes. Legislative changes have been enacted since 1986 or are under consideration in Brazil, Mexico, Korea, Taiwan, Malaysia, Indonesia, Thailand, Turkey and Poland, among other countries. These laws would establish considerably stronger protection for foreign owners of intellectual property, though enforcement of the new procedures should remain difficult for some time.

There appear to be two broad motivations for this shift in policy. First, some firms in developing countries seem to have developed a greater awareness of the possible benefits of stronger protection, including greater incentives for local innovation and more access to foreign technology. These business interests may be gaining political ascendancy in national debates over technology policies (Gadbaw and Richards, 1988).

Second, more general pressures on commercial policy have been exerted on IPRs. For example, as noted earlier, it has been suggested that enhanced intellectual property protection would attract more foreign direct investment because multinational enterprises would interpret it as a greater commitment by host-country governments to establish and respect private property rights.

Perhaps more important has been the role of foreign governments, most prominently that of the United States, in pressuring for policy changes. Since 1985 the United States has assigned high priority to defining as unfair trade practices the perceived deficiencies in IPR regimes in various nations. It has attempted to induce governments to modify or remove these deficiencies through application of its procedures under Section 301 as revised in the Omnibus Trade Act of 1988.

While such unilateral actions have achieved some success in the sense of procuring legislative changes in key developing countries, there are inherent dangers that continued use of this approach could result in discriminatory commercial agreements and more fragmented or targeted flows of world trade and FDI. It would be preferable to rely on a multilateral approach that might achieve a satisfactory balance of obligations and benefits in setting international standards for IPRs.

In this context, the most fundamental policy initiative is the effort to conclude an agreement on intellectual property in the Uruguay Round of trade negotiations. This effort has been championed by firms in the European Community, Japan and the United States that engage in significant product and technology innovation and artistic creation. Such an agreement would establish strong and non-discriminatory minimum standards for protecting various forms of intellectual property, transparent judicial mechanisms for enforcing them, and an avenue for dispute settlement within the GATT. The negotiation process has produced a draft text informally agreed to in good faith. The prospects for intellectual property in GATT depend on the overall balance achievable in the Uruguay Round. Such an agreement would bear some promise for enhancing global innovation and productivity and reducing bilateral tensions over IPR regimes. The EC could benefit in a number of dimensions, including the gains from a prospective agreement on greater protection for geographic appellations.

Finally, work continues within the World Intellectual Property Organization (WIPO), the umbrella organization overseeing the operation of the main multilateral intellectual property conventions, to redefine international standards and procedures for protection and to assist developing nations in modernizing their regimes. The most prominent current WIPO initiative is an attempt to establish a treaty for the harmonization of patent law within the framework of the Paris Convention. That effort has so far proved unsuccessful due to US insistence on keeping its 'first-to-invent' rule for awarding patents, in contrast to the 'first-to-file' rule in other countries, and to disputes over the definition of a grace period between first disclosure of a new invention and the date of its patent protection (Bardehle, 1991).

2.4. The situation in the European Community

The Community is actively defining appropriate legislation for intellectual property in the EC.[1] All Community Member States individually have legal protective regimes but there are important differences in relation to some IPRs which have a potential to hamper the free flow of goods and services. Thus, a harmonized EC legislation is highly needed. Such a regulation would provide benefits to Community and foreign businesses in terms of greater legal economic certainty, a wider scope for exploitation of trade marks, patents and other IPRs and the avoidance of costs associated

[1] For further details, see the chapter on intellectual property law in the Centre for European Policy Studies (1991).

with making applications for protection in all Member States and sustaining that protection. In turn, firms should experience higher returns on their R&D programmes, leading to greater technological dynamism in the Community.

Significant in this context will be the establishment of a Community trade mark, requiring registration only at a Community Trade Mark Office. Distinctive marks or names for products and services that are recognized throughout the Community should provide competitive benefits as firms would have enhanced incentives to undertake product development and sustain high quality. Elimination of national differences in trade mark regimes should result in freer movement of goods and services among Member States as businesses engage in EC-wide marketing. Potential threats to intra-EC competition associated with abuse of the trade mark registration system or anti-competitive trade mark exploitation could be disciplined by the vigorous use of EC competition law under Articles 85 and 86 of the Rome Treaty.

Similar comments pertain to the potential usefulness of a Community patent system, whereby a single patent would provide uniform scope of protection throughout the EC.[1] Again, this uniformity should increase business certainty, reduce administrative costs, contribute to EC-wide marketing programmes, and induce additional technology development within the internal market. As an indication of these possibilities, note that in the 12 EC Member States, 80% of the patent applications in 1990 were filed under either the European Patent Convention or the Patent Cooperation Treaty with patent grants to be made on the basis of these applications, while only 20% of the applications were filed directly with national patent offices.[2] Thus, the establishment of a Community trade mark and a Community patent may be viewed as a component of an EC strategy for competing in the global market as well.

The EC aims also at matching new technologies with adequate legislations. The most significant example is the modification to copyright practices, especially the protection that has been extended to computer programs. The EC has adopted strong minimum standards specifying exclusive rights for the author to reproduce, alter, distribute and rent new original programs. Faced with concerns that such a policy could result in monopolization and slow diffusion of important information technologies, user decompilation of programs for purposes of establishing interoperability of systems will be allowed under strict limits. This compromise is expected to safeguard the interests of small, innovative software firms for which interoperability with major systems is crucial.

The Community is also actively considering proposals for establishing and harmonizing copyrights or related rights covering databases, cable and satellite transmissions, home copying or sound and audiovisual recordings, and rental of recordings and cinematographic works.

As suggested by this brief review, the EC has a system of IPRs that is evolving into one of the most comprehensive, sophisticated and protective regimes in the world. Overall, this system may be expected to meet the needs of creative and technologically innovative interests in the 1990s, both in the EC and elsewhere. None the less, strong IPRs cannot be considered unambiguously to be beneficial, either in the EC or globally. A host of complicated issues needs to be considered in assessing the potential impact of changes in intellectual property protection. The report turns next to this question.

3. Economic arguments and evidence about IPRs

Societies have an interest in promoting creative activity. If innovative firms and individuals are not adequately compensated for the costs and risks of developing new products and artistic endeavours, such items would not be created. Societies would, therefore, forgo the considerable benefits of new technology development, product and quality differentiation, and cultural advancement. In providing such compensation, however, numerous difficulties could surface that should be considered in setting the IPR regime.

3.1. The economics of intellectual property rights

As noted earlier, private markets cannot, on their own, be expected to effect adequate payments in general for innovative activity. The basic difficulty is that the public-good aspects of new information (technologies and artistic creations) invite its unauthorized use by free-riding imitators. Put another way, markets may not provide sufficient mechanisms for excluding those who would exploit the information without providing compensation. Because this prob-

[1] Adoption of this system, as specified originally in the Luxembourg Convention of 1975, has been delayed by ratification difficulties in two Member States.

[2] See World Intellectual Property Organization, *Industrial Property Statistics*, 1990.

lem may be expected to lower the rate of innovation over time, markets suffer from the inherent dynamic inefficiency of allocating insufficient resources to creative activities. This situation may be corrected by providing legislative means of exclusion in the form of IPRs.

At the same time, however, societies are interested in procuring wide dissemination of new information. In economic terms, once a new technology is introduced it is socially optimal for the technology to be provided to users at the marginal cost of replicating it, which effectively may be zero. Thus, static efficiency requires that information be disseminated and used competitively, without regard for the sunk costs of developing it.

This trade-off between static and dynamic efficiency in the provision and use of information may be stated more precisely. By providing an exclusive right in the form of a patent, trade mark or copyright, society allows an innovating firm to sell a new product or technology at a monopolistic, rather than a perfectly competitive, price. This solution promotes dynamic creative activity, procuring net social benefits of consumer surplus and monopoly profits less R&D costs on new innovations. However, it incurs static social costs of excluding some consumption due to the excess of monopoly price over true marginal cost. This static deadweight loss may be interpreted as society's investment in information creation. Optimality requires that the system induce the introduction of all innovations for which *ex-post* consumer surplus exceeds R&D costs.

This description of the underlying intellectual basis for IPRs masks important complexities in markets for information. It is important to consider more fully the benefits and costs of promoting such markets and the role of intellectual property protection in doing so. For this purpose, discussion is organized initially by a major form of IPR.

3.2. Patents

Patents are issued by governments with two broad objectives in mind. The first objective is to encourage inventive activity and to stimulate the commercialization of new inventions, thereby offsetting the dynamic market distortion of underinvestment in technology.[1] The second goal is to promote the diffusion of knowledge by requiring its detailed disclosure in patent applications. Diffusion can be important in widening the technological base and realizing beneficial spill-overs that may lower costs in other industrial sectors.

The view that patents are important in promoting technology development has been criticized on several grounds. An obvious question is whether patents are really necessary to stimulate investment in R&D. Competitive rivalry in strategic markets may by itself be a sufficient incentive for invention that monopoly protection becomes unnecessary.[2] Further, market and technical barriers to imitation could allow inventive firms to charge a price above current production costs for a sufficiently long period to recover investment costs and to compensate for risks. Scherer (1980) notes conditions under which this outcome might prevail, including imitation lags due to secrecy, imperfect information transfer, and the complexity of successful imitation. Further, there may be advantages in being first to market a new product in terms of product-differentiating quality, image, and the like.

It is apparent that the private ability to appropriate the returns on innovation depends on a broad set of characteristics, including the degree of market imperfection, the technical ease of imitation, the pace of information transfer and the firm's abilities to control it, and demand parameters. In cases where innovation and development would transpire endogenously without patent protection, providing such protection would be redundant and simply create a welfare-reducing monopoly. In practice, however, it would be difficult to identify such cases since inventors generally do file for patents. It is hard to know whether the promise of a patent is the required stimulus to competition in R&D or simply a means of buttressing claims to the returns on invention.

It is worth noting some suggestive empirical evidence on some of these issues. Information about new products and processes becomes available to a firm's competitors fairly rapidly, generally in a one-to-two year period (Mansfield, 1985). The information is transferred through shifts of personnel, technical meetings and communications, communications with suppliers and customers, reverse engineering,

[1] Arrow (1962) notes also that the market will underinvest in creation if there is risk aversion among inventors and financiers. Patents may also diminish this problem, though insurance markets presumably offer a more efficient solution.

[2] On the relationships between market structure and innovation, see Kamien and Schwartz (1982).

and the study of patent applications. For these reasons, the ability of a firm to retain its technological information in-house is limited, diminishing the private returns to innovation.

However, the competitor's step from garnering the information to imitating the new product or process may be more difficult. Imitation is a costly activity, with costs including R&D, marketing, investment in production facilities, start-up costs, and, if necessary, the need to invent around a patent granted to the innovator. Indeed, these costs appear to be substantial. In a sample of firms in four American industries, average imitation costs totalled some 65% of innovation costs and imitation time equalled about 70% of innovation time (Mansfield et al., 1981). These costs depended significantly on market structure. Further, except for the pharmaceutical industry, patents had small effects on imitation costs and patented innovations were rather easily imitated, generally within four years of their initial introduction.

A further question is whether patents are viewed by firms as important in making their decisions to invest in innovation. Mansfield (1986) sampled 100 firms in 12 US manufacturing industries about their views on patent protection. From his results it appears that only in the pharmaceutical and chemical industries were patents considered essential, in the sense that more than 30% of their inventions would not have been developed in the absence of available protection. In three industries (petroleum, machinery and fabricated metal products) patents were seen as important in the development of between 10 and 20% of their inventions, while in the other seven industries patents were viewed as unimportant or only marginally significant in promoting R&D.[1] In summary, though there is substantial sectoral variation, the prospect of patent protection seems hardly to be the driving influence behind industrial inventive activity. Competitive pressures and strategies provide the bulk of the incentives for innovation.[2]

This last result does not mean that firms which introduce new products or processes do not patent them. Mansfield (1986) also found that, in his sample, a high percentage of patentable inventions were, in fact, patented, ranging from 50% in the primary metals industry to 86% in the petroleum and machinery industries. The remaining inventions were protected, to the extent possible, with trade secrets and private actions. Thus, although the promise of patent protection may not be critical for stimulating inventions, the benefits of such protection, including monopoly pricing, licence fees and royalties, and the costs imposed on imitators, are viewed as worth pursuing.

Taken at face value, the finding that patents are not critical in the decision to invent and are relatively ineffective at forestalling imitation, though welcomed for whatever benefits they do provide to firms, leads to doubts about the utility of the system. Consumers suffer from the associated monopoly pricing or other exclusionary practices but there is little offsetting stimulus to invention.

This view is somewhat naïve, however. Mansfield (1988) himself argues that the general weakness of the international patent system, exacerbated by the easy flow of technological information across borders, implies that the incentives for industrial innovation are limited and result in a suboptimal level of investment in new products. In other words, it is the ineffectiveness of the patent system that leads firms to view patents as unimportant; stronger patent protection would raise inventor activity and economic growth.

Moreover, this evidence is outdated. It is likely that patents have taken on increasing importance as R&D-stimulative devices as technological competition has become stronger and more globalized. While there is no clear definition of globalization,[3] it refers to growing trends toward commercial interdependence in high-technology products, involving both cooperative arrangements, such as joint R&D ventures, and competitive strategies, such as market interpenetration through foreign direct investment and marketing. In part, these tactics are an effort to control unauthorized inter-firm and international flows of proprietary technological information, the dispersion of which has become easier due to improvements in communication and the emergence of significant technical skills in many countries. A stronger and more harmonized patent system should increase the appropriability of technological innovations in this environment.

[1] Taylor and Silbertson (1973) present similar evidence for UK industries. See also Levin et al. (1987) for more recent corroborative evidence in the United States.

[2] Note, however, that these mechanisms may be buttressed by IPRs other than patents, such as trade secrets and trade marks. Thus, a more general concern over IPRs may be warranted. See also Scherer (1980).

[3] See Jacquemin (1991) for discussion of the structural characteristics of the new global competition.

In truth, there is little systematic evidence that natural market mechanisms for appropriating returns on innovation have been eroded and that stronger patents would correct the situation. This is an unfortunate gap in our understanding of the situation and leaves unresolved the important empirical question of whether greater protection of IPRs would call forth substantially more inventive activity. This question lies at the heart of the debate over international protection of IPRs.

A second criticism of patents relates to the terms under which they are provided. The issues concern the optimal length and breadth of a patent grant and the conditions for patentability. In industrial nations patents are granted for a period of 15 to 20 years with fairly narrow scope. Patentability conditions require that the invention be new, non-obvious, and commercially applicable. These terms represent a policy trade-off between the desirable invention-inducing incentives of patents and their information-diffusing properties on the one hand, and the reduction in consumer welfare from granting exclusive exploitation rights on the other hand.

From a welfare standpoint, the optimal patent would allow inventors just to recover their investment costs but no surplus. Thus, competition for patents should be allowed to continue until all private surplus is dissipated. Many analysts claim that this criterion calls for a short patent length and a narrow breadth. Others, however, note that the weakness of patent protection needs to be compensated by substantial length and breadth merely to recoup R&D costs. In fact, optimal policy would depend on market structure, including competition at the invention stage, and the need to disseminate information. At the least, one would expect the optimal patent grant to vary by industry or even by specific inventions.[1] However, because it is difficult to develop such a fine-tuned policy regime, countries provide fixed-term patents to all patentable inventions.

In the Community patents are typically granted for a fixed 20-year period. Whether this approximates an optimal patent length is an issue for continuing debate and future empirical work.

Equally important is the scope of patent protection, defining what practices the patentee may exclude competitors from undertaking, including the development of imitation products and technologies. Industrial nations traditionally have assigned rights rather narrowly, because the large majority of patents have been awarded to minor modifications, embodying little true inventiveness, of existing technology and products. The negative consumer-welfare implications of this policy are likely to be fairly minor since such modest inventions are easily imitated by inventing around the patent and the associated monopoly rents are likely to be small. In this context, fears of the monopoly powers conferred by patents are often exaggerated. It is a rare patented product that does not face significant legitimate market competition within a relatively short time-period.

To be sure, there have been exceptions to this observation, in which a patent on a key technology or pharmaceutical drug has supported high prices, restrictive licensing contracts and spectacular monopoly profits. Thus, patent protection can be excessive in a static sense and may also be dynamically inefficient to the extent that it results in socially wasteful duplication of research effort devoted to its circumvention and in patent races in anticipation of future profits. Different countries may take different approaches to this issue, leading to its inclusion on the negotiating agenda for international protection of IPRs.

Consider next the objective of providing patents to encourage the dissemination of technical information. This goal is accomplished by insisting that detailed descriptions of the new technology embodied in a product or process be included in the patent application. These applications are then published or made available for inspection by the public. Thus, while the specific idea in the patent is protected from duplication, the idea itself may be scrutinized by interested parties looking to improve the technology without duplicating existing effort. In turn, published patent applications serve, in principle, as an important conduit for technology diffusion and transfer. This is considered a principal benefit of the system, one that gives rise to subsidiary benefits (WIPO, 1988a). This author has found no systematic empirical evidence on this point. However, casual evidence suggests that foreign technical specialists make extensive use of published US and European patent documents, indicating that the system may enhance technology transfer.

Related to the question of technology diffusion is that of technology spillover. Scherer (1980) suggests that the main benefit of a patent system is that it may provide the necessary incentive for firms to undertake the risky, long-term research and development that leads to major technological breakthroughs, such as those underlying xerographic machines,

[1] See McFetridge and Rafiquzzaman (1986) and Klemperer (1990).

computers and semiconductors. Around these innovations will grow whole industries that use their technologies, improve on them, or develop residual applications. The social gains from major technological advances can far exceed private returns because their associated spillovers have a substantial positive impact on growth and welfare. On this point there is virtually no doubt.[1] In question here, however, is the empirical role of patents in this process. Once again, there is little evidence on this score due to the difficulty of constructing the appropriate counterfactual cases, but practitioners in this area suggest that protection plays an important role in spurring fundamental technological changes.

An important question is whether patents are the most efficient public policy for stimulating innovative activity. A policy regime would be deemed efficient if it procures the greatest increase in socially beneficial inventions per dollar expended on research and development. Patents have numerous disadvantages in this context. As noted, patents are usually awarded without differentiation among type of industry or invention. Thus, it is evident that the fixed-term patent structure is a crude design for effecting an optimal sectoral and dynamic resource allocation. Further, to the extent that patents are redundant in that a given flow of innovations would result in the market anyway, they result in a suboptimal income transfer from consumers to innovators. Finally, if a patent supports strategic licensing and marketing practices that retard the dissemination of technological information, society's growth is diminished.

Several alternative policies could be envisioned for technology development. At one extreme, governments might choose a strictly *laissez-faire* approach, in which IPRs are not provided and the market is trusted to provide sufficient compensation for investing in R&D. Obviously, this option has long since been rejected by most nations as unworkable. There is strong evidence to support this rejection, in that social returns on R&D markedly exceed private returns in industrial countries, pointing to the need for active government promotion (Mansfield, 1988; OECD, 1991a). Further, a *laissez-faire* approach surely would fail to procure rapid technological advance in key sectors that are vulnerable to imitation, such as pharmaceutical and metal processes.

Given that government involvement is required, three additional possibilities exist. First, it is possible in principle to design lump-sum transfers from consumers to inventors that could stimulate the same investment in innovation without suffering the pricing distortions of patent grants (Cheung, 1986). This argument is simply a variant of the well-known case for using tax-cum-subsidy schemes over tariffs and quotas to promote certain objectives in the economy. From a practical standpoint it suffers the same shortcomings, including the difficulty of effecting such transfers efficiently, the likelihood of excessive subsidization as research interests capture political power, and taxpayer resistance to explicit cash transfers.

As an alternative policy, the government might consider replacing the patent system with a more thorough role for itself in sponsoring and subsidizing promising innovative activity (Scherer, 1980). It could do this first by mandating the transfer to itself of rights to use new technologies in return for compensating inventors. The technologies could then be provided to potential users at marginal cost, with taxpayer outlays limited to the compensation. Again, difficult incentive problems would emerge in such a scheme. Unless compensation is tied to the expected present value of the invention, which is likely to be unpredictable given the uncertain nature of research and product development, inventive firms would have little reason to pursue the risky major advances in technology with significant spillover potential. It is more likely that public compensation schemes would be more rigidly established, imparting a bias for stimulating smaller inventions of limited value.

Finally, public authorities could consider a policy of active technology development through subsidizing R&D by private firms and establishing government research facilities. This is a key component of modern industrial policy, in which the essential goals are to nurture competitive strength in high-technology industries through promoting economies of scale and scope, and to develop associated spillover benefits. A wide span of policy tools could be employed for these purposes, ranging from setting industrial standards or allowing precompetitive R&D joint ventures among industrial rivals to public organization and ownership of research activities. Industrial nations are arrayed along this spectrum and the general trend is toward more active technology-creation policies.

It is beyond the scope of this report to evaluate the costs and benefits of high-technology industrial policies, which is a highly complex issue.[2] Two general comments are in order,

[1] Bresnahan (1986) provides strong evidence of these social gains from advances in computer technology and their adoption in financial services.

[2] See Udis and Maskus (1991) for an example using the aerospace industry.

however. First, public promotion of new technology should be limited broadly to supporting basic research, which may be defined as research leading to discoveries of general scientific principles that may or may not have wide industrial applicability. Such research embodies strong publicness in the sense that exclusion is neither practicable nor desirable, leading to free-rider problems and the failure of markets to provide it. Applied research, or the development of new products and technologies of direct commercial interest, should be left to private firms in market competition. The role of the government should be to stay in the background but to set the rules of the game, including competition policy and IPRs. Of course, the distinction between basic and applied research is difficult to make at the margin. The second comment is simply that high-technology industrial policies face the same problems that more general industrial policies engender, including excessive entry, rent-seeking behaviour, sharp increases in costs for scarce R&D resources, and potential foreign retaliation. Thus, governments should be cautious in setting such policies.

In this regard, a patent system provides distinct advantages over active industrial policy.[1] Rather than relying on government officials to identify potentially successful technologies, a task for which they are poorly suited, it allows market competition for protected future profits to allocate R&D resources. A proper allocation of capital and labour into technologically dynamic uses is crucial for economic growth (Grossman and Helpman, 1991). Because patents are typically provided without discrimination among applicants, this competition exists on an international rather than a domestic scale, which provides additional global benefits. In contrast, industrial policy is inherently discriminatory. For the same reason, patents might enhance the international diffusion of new technologies through published patent applications more readily than might be the case under government provision and control.

As noted earlier, patent regimes are not socially optimal policies for numerous reasons. Whatever benefits they provide come at some costs to society. Patents are of limited scope and duration in order to cap welfare costs from monopoly pricing or potential domination of important new fields of technology. Again, it is an open question as to how well this system, in combination with appropriate competition policy, secures an efficient resource allocation. None the less, it provides the best compromise available for promoting technological investments in industrial countries. Thus, a policy focus on greater harmonization, at least among that group of nations, bears some promise for raising global innovation, productivity, and growth.[2]

3.3. Copyrights

Copyrights protect the rights of creators of literary and artistic works to communicate, display or perform those works in some medium. In the classic definition, literary and artistic ideas are without industrial applicability or utility. Thus, granting monopoly protection on artistic ideas, such as the writing of a book about a particular historical event, would stifle creativity and intellectual debate with little social benefit in return. However, particular expressions of an idea deserve protection in order to avoid an underproduction of cultural and creative activity. These considerations underlie the structure of copyright protection.

The fundamental economic problem necessitating copyrights is related to the need for protecting industrial property. Creative literary and artistic works provide social, cultural and economic benefits that society wishes to secure. These works involve investment costs, including training, time, materials, technology acquisition, and the like. If other members of society were allowed to enjoy or exploit them without compensating their creators, the incentives to create would be severely dampened. Static economic efficiency might be enhanced at the sacrifice of growth in cultural identity. At the same time, however, providing exclusive control over the use of the works could result in their excessively narrow dissemination. Copyright systems reflect a compromise between these difficulties.

In comparison with patents, there is no hard evidence regarding the efficiency with which copyrights promote their social objectives. Again, protection could be excessive or insufficient compared to some socially optimal criterion for transferring consumer surplus to creators. Such a criterion would be practically impossible to implement, however, since the associated copyright policy would depend on the characteristics of particular cases. For example, there may be private mechanisms that secure remuneration to the creators, the strength of which would depend on such market parameters

[1] Clearly, the patent system may be viewed as part of an industrial policy regime to the extent that it discriminates in favour of certain industries or in favour of domestic technology development. A fair characterization is that *de facto* domestic patent discrimination has been useful in promoting technological development in a number of industrial countries, including Japan and the United States.

[2] An important example of potential harmonization lies in resolving the difference between the American system of awarding patents to the first to demonstrate invention and the system of the rest of the world, which awards the first to file for a patent. This is an important distinction because the US system provides an effective grace period in which an inventor can publish his results without losing the right to have the invention patented, while the other system encourages early (and perhaps excessively broad) filing and disclosure through applications. To date, this difference has not been overcome in international negotiations.

as the accessibility of the subject-matter, the advantages of being first in differentiating the creative product, and elasticity of demand. However, the existence of low-cost duplication and distribution activities suggests that private mechanisms fail to protect literary and artistic property.

Governments might attempt to design other policies that achieve artistic creativity at lower cost than copyrights. A system of direct taxes and subsidies could be justified for this purpose, as could most government support programmes for the arts. For political reasons, however, thorough government provision of cultural activities may be expected to result in inefficient bureaucracy that is unresponsive to consumer preferences in the arts. Overall, a system of copyrights with uniform protective standards that allows market demand largely to reward creators provides an appropriate solution.

While these questions are interesting, traditional copyright concerns are not the main issues in the current debate over artistic intellectual property rights. There are two reasons why copyrights have taken on greater urgency in recent years. First, improved technologies for duplicating copyrighted media have lowered the costs of infringement, encouraging piracy and reducing the returns on creative activity.[1] Second, the emergence of new products and technologies in computer programs, semiconductor devices, and electronic transmission of data and broadcast signals has blurred the basic distinctions between patentability and eligibility for copyright. Such changes are forcing a re-evaluation of basic copyright policies (Peyton, 1986; Novos and Waldman, 1987; Liebowitz, 1986).

That copying technologies have improved and become more accessible to consumers and infringers of intellectual property is evident. High-quality photocopying of books and journals is available at reasonable cost while audio and video recordings are easily and faithfully duplicated onto blank recording media. These reductions in copying costs have encouraged greater legal and illegal duplication of authorized copies, for private use or resale. Members of the EC have attempted to correct this problem within their markets by levying a tax on the sale of blank recording devices, with the proceeds distributed to artists, performers and broadcasters through centralized copyright associations. The Community is also considering extending this protection by establishing rights to control rental of creative property.

The growing complexity of the copyright problem has spurred the development of market responses by firms. One strategy has been to tie the sale of a copyable good, such as a computer program, to that of a complementary good that is not copyable, such as the computer itself. Characteristics of demand for the latter good may allow greater appropriation of rents to the development of the program than would a traditional untied marketing strategy. Another approach has been to make copying costly through, for example, copy protection on programs. Such responses thus far have been insufficient broadly to eliminate copyright infringement, but have raised concerns over potential monopolization of certain computer software markets.

Copyright has been an area of policy concern because of the need to develop appropriate protection for evolving technologies in computer programs, semiconductors and electronic transmission of signals and data. Regarding computer programs, most industrial countries have moved to provide standard copyright protection since programs are expressed in a literary medium and do not have direct industrial utility. This is the approach in the Community, where the regulation allows program purchasers to make back-up copies and to attempt decompilation of a computer code under limited circumstances. From an economic standpoint, allowing such decompilation (or 'reverse engineering') is a sensible policy for it is a key factor in ensuring the mutual compatibility of programs across different operating systems. Without this possibility, program markets could become excessively fragmented, damaging the introduction and dissemination of computer technologies through the economy.

At the same time, US courts have found in some circumstances that copyrights provide insufficient protection for programs. Such protection would cover the specific programming code developed by a firm or software writer rather than the idea to write a program devoted to a specific task. Thus, the copyright may be easily circumvented by imitators who need only rewrite the code sufficiently to convince the courts that the imitating program did not result from 'slavish copying'. It follows that copyrights provide weak protection for software and may not address well the appropriability problem. In the United States, for example, numerous spreadsheet programs are now marketed despite copyrights awarded to the Lotus Corporation. Further, private copying of microcomputer software is so widespread that relatively few firms make an effort to impede it significantly.

Given this difficulty, some observers have advocated providing patents to some software on the theory that certain programs constitute an industrial process with commercial utility, such as accounting programs or those running industrial controls. Most countries have avoided this interpretation on the view that a set of computer instructions or

[1] The welfare implications of restricting unauthorized copying are more subtle than simple tradeoffs between creators' rents and consumer surplus. For example, broadcasters may have an interest in allowing unrestricted home copying if raising copying costs through additional copyrights lowers overall viewership and advertising revenues. See Johnson (1985), Novos and Waldman (1984), and Liebowitz (1985).

symbols cannot constitute an invention. However, recent practice in the United States has been to grant growing numbers of patents to software developers (Bulkeley, 1989). Because of the far greater degree of control over the scope of imitation provided by a patent than a copyright, this trend has occasioned growing concern over its potential impacts on small software developers, software users, and, ultimately, the growth and vitality of the programming industry.

With respect to semiconductors, the question is whether to protect the design of integrated circuits. When costly new topographies are introduced in the market, it is fairly simple for competitors to copy them or improve on them slightly through reverse engineering. Industrial countries, including the Community, have recognized the need for a unique protective mechanism for chip topographies. These designs are not easily 'copyrightable' since they are not communicable expressions of an idea. Neither are they readily patentable because a circuit design does not contain an inventive step. Thus, the protection provided is somewhere between patent and copyright: upon registration and certification of newness the design is protected from unauthorized copying and distribution of products incorporating it for 10 years, subject to limited exceptions.

Finally, there is the area of electronic signal transmission. For example, the required technologies for receiving a satellite broadcast have evolved and become sufficiently inexpensive that it is difficult and costly for the broadcaster to practise exclusion in reception. Some who receive the broadcast without authorization may then benefit commercially from it by displaying it to paying patrons or by retransmitting it via local cable systems. Such actions reduce the value of the copyright owned by the programme's producer and the neighbouring right owned by its broadcaster.

The private solution, whereby broadcasters scramble their signals and make them unintelligible to all but authorized receivers, may be socially inefficient. It achieves exclusion, thereby sacrificing consumer benefits, but incurs a cost to the broadcaster that may approximate the original loss in copyright value, leaving a net potential loss in welfare. The Community is attempting to establish a harmonized policy in member countries that would transfer greater payments to broadcasters, through collective agencies, based on potential viewership in different regions. It remains to be seen how effectively this new regime will discipline the free-rider problem.

One alternative might be the US compromise, in which broadcasters get limited copyright protection plus remuneration from cable operators at a price set by the government. Cable operators effectively receive a compulsory licence to carry the broadcast in question. This solution may also be suboptimal because compulsory licences constitute involuntary transactions by the broadcaster that may stifle further programme development.

Related questions surface with respect to telephone transmission of databases and other proprietary information among computers. Again, exclusion is feasible but costly, particularly when transmission is over telecommunications networks with multiple users. Databases may be copyrighted in some countries to encourage their development and sale. Laws covering trade secrets may also help protect their proprietary information. But when such information is transmitted the difficulty of exclusion raises policy concerns like those discussed above for broadcasts. Copyright policies are evolving over this point. There is a substantive international component to this issue since such transmissions are often trans-border and countries assert the right to regulate the amount and type of information flows crossing their borders.

3.4. Trade marks

A variety of devices exist to identify and protect the uniqueness of specific goods and services of firms, including trade marks, service marks, brand names, and marks of origin. Though there is some variance in how these mechanisms operate (WIPO, 1988a) and their impacts on economic incentives, they all have the same basic purposes. Therefore, it is sufficient to consider the economic issues by discussing only the most prevalent form of such protection, trade marks.

Trade marks carry legal authority to enforce the exclusive use of a symbol or other identifier that conveys information to the customer about the product being purchased. If consumers view the mark as a reliable indicator of high quality, they will be willing to pay a premium price for the good. This premium price compensates the firm for the cost of developing and advertising the trade mark. If competitors were allowed to duplicate the mark or use a confusingly similar mark these costs could not be recovered. Society would suffer from deficient investment in product development and quality. At the same time, trade marks serve in part to augment the ability to differentiate products and to sustain associated monopoly profits. Critics contend that this makes trade mark protection less desirable than other forms of IPRs.

A balanced view of the need for trade marks lies between these extremes (Landes and Posner, 1987). Assuming a pro-

posed mark is sufficiently distinctive to be accorded protection,[1] the resulting trade mark provides certain benefits to society. Over time the trade mark will become an indicator of the inherent quality of the product it identifies. If the firm sustains a relatively constant degree of quality, then consumers know what to expect when buying strictly on the basis of trade marks. This signal lowers consumers' costs of searching for preferred quality attributes. Trade mark protection gives firms an incentive to maintain or improve quality over time because to do otherwise would diminish their reputations and erode the value of their marks. Thus, trade marks may be expected to increase the average quality of products on the market.

A secondary, though highly visible, function of trade marks is to accommodate tastes for exclusivity in consumption. The ability to buy such products as Louis Vuitton luggage at exclusively high prices provides utility to consumers who wish to achieve a distinctive lifestyle (Higgins and Rubin, 1986). The need for protection is evident. Competitors would otherwise free-ride on these products by duplicating their trade marks and attaching them to lower-quality goods.

Trade mark protection can be socially costly, however. Trade marks may promote inefficient forms of product differentiation by inducing firms to advertise and claim a dubious image of high quality. Such claims could procure monopoly profits by misleading consumers into purchasing higher-priced goods with no offsetting increases in quality. Competitive advertising by firms could also lead to socially wasteful resource misallocation. The result of these factors could be net deadweight losses associated with trade marks.

Most economists view these potential costs as limited, though there is little systematic evidence on the subject. First, the monopoly power associated with a particular trade mark is likely to be small because the potential supply of competing trade marks is virtually unlimited. Second, legal structures generally prevent false and misleading advertising. Third, consumers are capable of assigning quality valuations to goods. If firms provide low quality, consumers will discount the trade marks. Since firms have an incentive to safeguard their reputations and trade marks, misleading activity is expected to be minimal in well-functioning markets.

A trade mark grants exclusive authority to a firm to distribute its products with the assistance of a particular and distinctive identifying mark. Distinctiveness is important because protecting non-distinctive marks could impose costs on society without generating the requisite information to lower consumer search costs. In EC Member States, trade marks are awarded to the first person to register them with the government. This registration system provides legal certainty about ownership and helps avoid inadvertent duplication of trade marks, but may encourage excessive investment in trade mark development as firms attempt to register all potentially interesting or descriptive names and symbols in a prospective product line. Moving to a system of awarding Community trade marks through a single centralized registration should diminish this problem in Member States. The greater advantage of a Community trade mark should be to improve the efficiency of advertising and distribution efforts for firms in the unified market.

4. Policy issues for IPRs in the international economy

The discussion to this point has analysed the inherent trade-offs with which each economy must contend in setting its IPRs policies. Additional issues arise in considering relationships among nations with varying levels of protection. As mentioned earlier, these issues have become the basis for international debate and negotiations over greater harmonization in intellectual property regimes.

4.1. Economic aspects of international harmonization

It must be stressed that, in principle, international agreements to establish reasonably homogeneous systems for IPRs could raise or lower international trade in goods, investment and technology. Further, either outcome could be economically inefficient and reduce global welfare as it internationally redistributes benefits from protection. The reason for this problem was indicated earlier. Protecting intellectual property imposes a static distortion (potential monopoly practices) in the economy in order to overcome a dynamic distortion (insufficient investment in innovation). Therefore, IPRs are supposed to be practical solutions to an inherently second-best problem. In principle, any solutions may raise or lower welfare and must be assessed on a case-by-case basis.

The widespread support of IPRs in the industrial countries is consistent with the presumption that their dynamic benefits have significantly outweighed any static monopolization problems. It is likely that both economic growth and the satisfaction of consumer tastes for variety and quality in

[1] See WIPO (1988a) for conditions under which protection may be granted.

these nations have been advanced materially through the use of patents, trade marks and copyrights. Continued redefinition and harmonization of IPRs should strengthen these influences in the future. One advantage of greater standardization among the industrial countries would be that R&D and marketing resources would be devoted to projects with the highest expected payoffs across all participants rather than to those in countries with the strongest protection. It could also raise the efficiency of financing R&D programmes by allowing monopolistic firms to price-discriminate across markets, extracting the greatest surplus from countries with the highest demand for new products. The application of these principles to the EC internal market is clear.

Other areas may potentially be faced with higher costs of acquiring some new products and technologies, but offsetting welfare benefits would exist also, however. The additional profit potential may induce foreign firms to undertake more invention of new products designed for these markets, thereby expanding consumer choice (Diwan and Rodrik, 1991). It may also encourage greater innovation by domestic firms, enhancing local technology. And, as noted above, stronger protection could stimulate further inward FDI and technology transfer. However, it remains an open question as to how significant these responses would be.

Whether a particular country would experience net costs or benefits from providing stronger protection depends on its circumstances. Stated in different terms, proposals to change global IPR policies have both efficiency and equity aspects. Overall, standardization could advance world dynamic efficiency inducing greater innovative efforts. In the multilateral context, a balance of advantages for movements towards global harmonization of IPRs could appropriately come from a comprehensive agreement in the Uruguay Round that guarantees greater access to markets in the developed countries for products in which developing nations have a clear export advantage.

4.2. IPRs in a broader policy context

It must be recognized that IPRs are one component in a broad array of economic policies for promoting growth and welfare. While it is important to establish a thorough, transparent and effective system for protecting intellectual assets, the system chosen is secondary to maintaining sound macroeconomic and commercial policies. Innovation and technology diffusion are hampered in economies with slow growth and erratic or inflationary monetary and fiscal policies. Arbitrary business regulations and uncertainty about future tax policies are also restraining factors. In short, countries must pursue sound and stable aggregate policies before expecting IPRs to function effectively.

This situation is evident in countries with significant trade restrictions and regulated capital markets. These barriers unilaterally prevent access to key inputs and technologies and inefficiently limit potential market size. For a country in which such restrictions are common, strengthening its IPR policies alone would be likely to generate little rise in domestic innovation or inward FDI and technology transfer. It could be costly, however, both in static terms through higher prices and in a dynamic sense by pulling scarce R&D resources into protected and inefficient industries (Nogues, 1990). Thus, general liberalization of commercial policies is the sensible prerequisite for successful changes in IPRs. In this context, emphasis on establishing reasonable commonalities across the broad scope of economic policies in the EC internal market is appropriate. Given the clear links between intellectual property rights and foreign direct investment as discussed earlier, progress on implementing measures concerning investment incentives and disincentives would also assist in the economic rationalization of creative activity.[1]

In allowing intellectual property to be exploited, authorities must remember that the chief danger of strong IPRs is the potential for establishing abusive positions of market power. Again, there is a delicate balance between society's need to promote innovation and its interest in ensuring effective market competition (OECD, 1989).

The link between competition policy and IPRs is complicated, requiring officials to assess in particular cases whether the grant of a patent, trade mark or copyright results in pricing behaviour or licensing agreements that excessively damage market competition. In most cases, the potential for cartelization or predatory behaviour is likely to be slight as alternative products and technologies limit market power (Maskus and Eby-Konan, 1992). This suggests that a regulatory presumption that IPRs should be allowed to operate typically without interference is desirable.

Nevertheless, as technological rivalry intensifies and firms turn more frequently toward joint ventures, patent-pooling arrangements and cross-licensing agreements, the potential

[1] See the paper by Professor Greenaway in this volume for an analysis of investment measures.

for abuse of IPRs may be growing. For example, providing a patent on a key computer program or biotechnological invention may risk allowing one firm to dominate an important area of technology, diminishing potential for its diffusion and subsequent economic growth. Competition authorities must have the ability to ensure effective competition through appropriate judicial procedures, safeguarding the interests of the innovative firm to the extent possible. The report by Professor Vosgerau on competition policy in this volume provides a detailed analysis of such issues.

That these issues are complicated should not deter policymakers from working toward efficient and acceptable systems of IPRs. Within the EC, the preponderance of economic interests would be advanced by a regime of strong protection with greater policy harmony across Member States. It is certain that the Community will need to take a leading role in finding common international ground for policies in the 'new areas' of services, investment and intellectual property. Expanding business internationalization in the 1990s will demand nothing less.

Annex 1: Definitions and functions of intellectual property rights

Intellectual property is the asset generated by creative action, such as invention or authorship. As with more tangible forms of private property, the owners of intellectual property are, in most countries, allowed to garner its returns through commercial exploitation.

Unlike tangible property, however, intellectual property derives from the creation of new information, which is essentially a public good. Accordingly, the problem arises that market participants have little incentive to compensate the inventor once the information underlying the invention becomes known. Information is non-rivalrous in consumption. Its use by the inventor does not diminish any imitator's ability to use it as well.

This problem necessitates the establishment of a set of protective devices that go beyond forms of protection for ordinary property. These devices assign and preserve the rights to exploit intellectual property. In general, IPRs refer to the legal authority of a creator to control the means by which the new information or idea is disseminated and commercialized and to the enforcement mechanisms to which the creator may appeal to prevent unauthorized use.

There are two general forms of intellectual property and each has evolved rights-preserving protective schemes (World Intellectual Property Organization (WIPO), 1988a).

The first form is industrial property, relating to creations of value to industry and commerce. Typically, these creations include inventions that provide new solutions to technical problems and industrial designs and marks that distinguish a product or clarify its characteristics. Protection of industrial property comes in various forms, including patents, registered industrial designs, trade marks, service marks, trade names and indications of source. Further, industrial property is protected by laws disciplining unfair competition that infringes the legal right to exploit new products or processes.

The second form is artistic property, relating to literary and artistic creations, such as books, music, pieces of art and filmed works. Such creations are protected by copyrights, which provide at a minimum that the creator has the right to exercise control over the copying of the work, though this right is generally assigned by the creator to his publisher or agent. Copyrights may extend further to 'author's rights' or 'moral rights', which extend to the creator the right to prevent subsequent distortions to, and distorted reproductions of, his creation after it has been sold.

An increasing number of countries also provide 'neighbouring rights', which protect performers and broadcasters from unauthorized public communications and reproductions of their performances and music producers from unauthorized duplication and sale of their records, tapes, and so on.

Turning to definitions and terms of specific IPRs, protection of industrial property takes several forms. The first device is the patent, which confers an exclusive right to exploit (that is, to make, use, sell, and import an invented product or to use an invented process and to control production and use of products made from a new process) an invention or to authorize others to exploit it. The patent recipient is protected from unauthorized exploitation for a fixed term, generally between 15 and 20 years.

For an invention to be patentable it must typically meet three criteria: it must be new (that is, previously unknown), it must contain a non-obvious or creative step, and it must have industrial applicability (that is, it must have practical 'utility'). The last criterion exists to prevent, under most laws, the patenting of fundamental scientific discoveries flowing from the basic physical laws of nature. Two general exceptions to the exclusive-rights provisions exist (WIPO, 1988a). First, a government may elect to exploit an invention itself on public-interest grounds. Second, the government may issue a compulsory licence mandating that the patent recipient allow exploitation by another entity that may have failed in attaining authorization otherwise. Compulsory licences usually provide fixed payments to the patent owner. These basic patent terms reflect a compromise between an inventor's need for compensation and society's need for technological advance and information diffusion.

An important variation on the basic patent exists in many countries. 'Utility models' are mechanical inventions with much less stringent requirements for non-obviousness. Since these inventions embody less technological progress and are easier to develop than regularly patentable inventions, they receive patent protection of shorter duration.

A second protective device for industrial property is the registration of an industrial design. An industrial design is the aesthetic or ornamental aspect, involving shape, pattern, and/or colour, of a useful commercial article. The design must be associated with the industrial article itself or else the design would be considered a potentially copyrightable artistic work. Industrial designs are protected from unauthorized copying or imitation, generally for a period of 5 to 15 years. As distinctive packaging and product form have become increasingly important elements of competitive strategy, industrial interests in design protection to compensate for the costs of design development have increased markedly.

The next form of protection consists of distinctive registered marks, including trade marks, service marks and trade names. The primary function of these devices is to safeguard the reputation for high quality of firms and specific goods and services they sell. At the same time such marks act as a signal of quality to consumers, thereby lowering their search costs and insulating them from confusion, fraud and other undesirable business practices. Simply put, a trade mark (service mark) is a distinctive symbol that identifies the provider of a good (service). Such marks may be pictorial devices, a single letter or numeral, an entire phrase or sentence, or any combination. Trade names identify an entire enterprise rather than specific goods and services but otherwise serve similar purposes.

Generally, registration of industrial marks is required to receive protection from infringement (duplication of marks or the use of confusingly similar marks) but a few countries, including the United States, recognize also simply the commercial use of a new and distinctive mark as sufficient to procure protection. Trade mark protection is granted indefinitely though periodic re-registration is typically required.

Indications of source or, equivalently, appellations of origin receive protection under most national laws also. These indications signify a geographical area from which a product originates and serve to identify product characteristics that derive specifically from that location. They are most often used to indicate geographical origins of a particular form of spirits and are intended to provide a further signal of quality to consumers.

Finally, countries provide different levels of protection for industrial property in their domestic legal structures against unfair business competition. What constitutes unfair competition varies widely across nations and, in principle, covers a broad set of business practices (WIPO, 1986, 1988a). Examples would include industrial espionage, bribery, dumping, and unauthorized disclosure of a competitor's technical information. From the standpoint of industrial intellectual property, perhaps the most significant protection is that provided by trade secrets, which refer to unpatented proprietary technical information, such as a production process or chemical formula. Trade secrets are an important competitive strategy for many firms; and legal recourse against employees who divulge such information and competitors that acquire it is available in the judicial systems of some countries.

With respect to copyrights, protection is provided to the expression, such as a publication or film, of an idea rather than, as with patents, the idea itself. Thus, with limited exceptions, books, music, and the like cannot be duplicated without authorization by the creator or his designated agent. However, the ideas contained therein may be used by others without compensation or authorization, so long as other expressions of the ideas are not generated by 'slavish copying' of the originals. Generally it is up to the courts to decide if a copyright has been infringed.

To be copyrighted, the expression of an idea must be an original creation of the author or artist, though the idea need not be novel. Protection is provided regardless of the apparent quality of the work or the use for which it is intended. Finally, in most countries the expression of the idea must be established in some tangible form, such as a book or a recording, before it is accorded protection. Copyright is generally provided to the creator for his lifetime and to his heirs for at least 50 years after his death.

In recent years questions have surfaced about the ability of these mechanisms to provide appropriate levels of protection for certain forms of technological innovation. Computer programs, for example, might be insufficiently protected by a standard copyright in that their operation could be imitated by the rearrangement of lines in the programming code without necessarily violating the 'slavish copying' standard. Thus, while copyright remains the typical device in countries that protect programs, judicial and legislative practice in the United States and the Community have moved toward providing stronger protection *de facto*.

Similarly, the designs of semiconductor devices (or 'chip topographies') are easily copied; and most industrialized nations have chosen to establish a unique, or *sui generis*, form of protection that is a hybrid of copyright and patent. A further issue concerns the eligibility for copyright of information databases, which are typically compilations into useful forms of data prepared by others. The question arises as to whether simply the literal expression (that is, the order) of the data may be protected or whether the copyright should be broader.

Finally, intriguing issues surface with respect to the patentability of biotechnological innovations, or new microbiological plants and animals with commercial utility. Some have argued that it is unethical to provide exclusive economic rights to the exploitation of living organisms, even if the development of those organisms requires intellectual creativity on the part of inventors. At least among industrialized countries, a consensus has emerged that such organisms should be patentable.

For additional details see WIPO (1986, 1988a, 1988b).

Annex 2: Industry classifications for patent, trade mark and copyright goods

Following is a list of the goods classified into patent, trade mark and copyright goods for the figures in Table 77 of the text:

Patent goods

SITC 512	Alcohols, phenols, etc.
SITC 541	Medical and pharmaceutical products
SITC 583	Polymerization products, etc.
SITC 728	Other machinery for special industries
SITC 736	Metalworking machine tools
SITC 751	Office machines
SITC 752	Automatic data-processing equipment
SITC 774	Electro-medical and X-ray equipment
SITC 7764	Electronic microcircuits
SITC 87413	Surveying, measurement, drawing and gas control instruments

Trade mark goods

SITC 112	Alcoholic beverages
SITC 553	Perfumery, cosmetics, etc.
SITC 665	Glassware
SITC 784	Motor vehicle parts and accessories
SITC 821	Furniture and parts thereof
SITC 831	Travel goods, handbags
SITC 84	Clothing
SITC 8851	Watches, movements, and cases
SITC 8942	Toys, indoor games, etc.

Copyright goods

SITC 89212	Printed books, globes, newspapers, periodicals
SITC 8983	Sound recording tape, discs

References

Arrow, K. (1962), 'Economic welfare and the allocation of resources for inventions' in *The rate and direction of inventive activity: economic and social factors*, National Bureau of Economic Research, Princeton, NJ, pp. 609-25.

Bardehle, H. (1991), 'The WIPO harmonization treaty and the grace period', *Industrial Property*, October, pp. 372-76.

Bresnahan, T. (1986), 'Measuring the spill-overs from technical advance: mainframe computers in financial services', *American Economic Review*, pp. 742-55.

Bulkeley, W. (1989), 'Will software patents cramp creativity?' *Wall Street Journal.*

Centre for European Policy Studies (1991), *The annual review of European Community Affairs.*

Cheung, S. (1986), 'Property rights and invention' in J. Palmer and R. Zerbe, Jr, eds, *Research in law and economics*, Vol. 8 —'The economics of patents and copyrights', JAI Press, Greenwich, CT, pp. 5-18.

Diwan, I. and Rodrik, D. (1991), 'Patents, appropriate technology, and north-south trade', *Journal of International Economics*, pp. 27-47.

Feinberg, R. and Rousslang, D. (1990), 'The economic effects of intellectual property rights infringements', *Journal of Business*, pp. 79-90.

Gadbaw, T. and Richards, eds (1988), *Intellectual property rights: global consensus, global conflict?*, Westview Press, Boulder, CO.

Grossman, G. and Helpman, E. (1991), *Innovation and growth in the global economy*, MIT Press, Cambridge, MA.

Higgins, R. and Rubin, P. (1986), 'Counterfeit goods', *The Journal of Law and Economics*, pp. 211-30.

Horstmann, I. and Markusen, J. (1987), 'Licensing versus direct investment: a model of internalization by the multinational enterprise', *Canadian Journal of Economics*, pp. 464-81.

Jacquemin, A. (1991), 'Strategic competition in a global environment', in OECD, *Trade, investment and technology in the 1990s*, OECD, Paris, pp. 13-32.

Johnson, W. (1985), 'The economics of copying', *Journal of Political Economy*, pp. 158-74.

Kamien, M. and Schwartz, N. (1982), *Market structure and innovation*, Cambridge University Press, Cambridge.

Klemperer, P. (1990), 'How broad should the scope of patent protection be?', Centre for Economic Policy Research, Discussion Paper No 392.

Landes, W. and Posner, R. (1987), 'Trade mark law: an economic perspective', *The Journal of Law and Economics*, pp. 265-309.

Levin, R. et al. (1987), 'Appropriating the returns from industrial research and development', *Brookings Papers on Economic Activity*, pp. 783-820.

Liebowitz, S. (1985), 'Copying and indirect appropriability', *Journal of Political Economy*, pp. 945-51.

Liebowitz, S. (1986), 'Copyright law, photocopying and price discrimination' in J. Palmer and R. Zerbe, Jr, eds, *Research in law and economics*, Vol. 8 — 'The economics of patents and copyrights', JAI Press, Greenwich, CT, pp. 181-200.

Mansfield, E. (1984), 'R&D and innovation: some empirical findings' in Z. Griliches, ed., *R&D, patents, and productivity*, University of Chicago Press, pp. 127-48.

Mansfield, E. (1985), 'How rapidly does new industrial technology leak out?', *Journal of Industrial Economics*, pp 217-23.

Mansfield, E. (1986), 'Patents and innovation: an empirical study', *Management Science*, pp. 173-81.

Mansfield, E. (1988), 'Intellectual property rights, technological change, and economic growth' in C. Walker and M. Bloomfield, eds, *Intellectual property rights and capital formation in the next decade*, University Press of America, Lanham, MD, pp. 3-26.

Mansfield, E. et al. (1981), 'Imitation costs and patents: an empirical study', *The Economic Journal*, pp. 907-18.

Maskus, K. (1990), 'Normative concerns in the international protection of intellectual property rights', *The World Economy*, pp. 387-409.

Maskus, K. and Eby-Konan, D. (1992), 'Trade-related intellectual property rights: issues and exploratory results', forthcoming in R. Stern and A. Deardorff, eds, *Analytical and negotiating issues in the Uruguay Round*, University of Michigan Press, Ann Arbor.

McFetridge, D. and Rafiquzzaman, M. (1986), 'The scope and duration of the patent right and the nature of research rivalry' in J. Palmer and R. Zerbe Jr, eds, *Research in Law and Economics*, Vol. 8 — 'The economics of patents and copyrights', JAI Press, Greenwich, CT, pp. 91-120.

Nogues, J. (1990), 'Notes on patents, distortions and development', The World Bank, Working Paper No 315.

Novos, I. and Waldman, M. (1984), 'The effects of increased copyright protection: an analytical approach', *Journal of Political Economy*, pp. 236-46.

Novos, I. and Waldman, M. (1987), 'The emergence of copying technologies: what have we learned?', *Contemporary policy issues*, pp. 34-43.

Organization for Economic Cooperation and Development (1989), *Competition policy and intellectual property rights*, Paris.

Organization for Economic Cooperation and Development (1991a), *Science and technology industry review*, Paris.

Organization for Economic Cooperation and Development (1991b), *Basic science and technology statistics*, Paris.

Peyton, D. (1986), 'A new view of copyright', *Journal of policy analysis and management*, pp. 92-98.

Rapp, R. and Rozek, R. (1990), 'Benefits and costs of intellectual property protection in developing countries', National Economic Research Associates, Working Paper No 3.

Scherer, F. (1980), *Industrial market structure and economic performance*, Houghton-Mifflin, Boston, 2nd edition.

Sherwood, R. (1991), *Intellectual property and economic development*, Westview Press, Boulder, Co.

Taylor, C. and Silbertson, Z. (1973), *The economic impact of the patent system*, Cambridge University Press, Cambridge.

Teece, D. (1977), 'Technology transfer by multinational firms: the resource cost of transferring technological know-how', *The Economic Journal*, pp. 242-61.

Udis, B. and Maskus, K. (1991), 'Offsets as industrial policy: lessons from aerospace', *Defence Economics*, pp. 151-64.

United States International Trade Commission (1988), *Foreign protection of intellectual property rights and the effect on US industry and trade*, GPO, Washington.

World Intellectual Property Organization (1986), *The elements of industrial property*, WIPO, Geneva.

World Intellectual Property Organization (1988a), *Background reading material on intellectual property*, WIPO, Geneva.

World Intellectual Property Organization (1988b), *Symposium on the effective protection of industrial property rights*, WIPO, Geneva.

World Intellectual Property Organization, 1990, *Industrial property statistics*, WIPO, Geneva.

Annexes

Annex I — A concise overview of the EC trade policy[1]

Introduction

The purpose of this chapter is to provide a concise overview of the main elements characterizing the Community trade policy. The first section contains a brief summary of the general process of decision-making in the Community and the way it affects the nature of Community trade decisions, with reference made to recent internal developments affecting the Community's trade policy. The second part is a description of the main instruments that characterize the Community's trade regime, while the last section recalls the main preferential trade arrangements with a number of trade partners.

1. Trade policy decision-making in the Community

1.1. Main features of the institutional process

The Rome Treaty provides that all decisions that are general in scope or considered very important in policy terms are taken by the Council of Ministers. Apart from some limited cases, however, the Council can only decide on the basis of a Commission proposal. The Commission is thus the engine of Community policy as well as being the custodian of the Treaty and the executive arm of the Community whereas the Council is the legislative arm.

In general, Commission proposals pass through a decision-making process with Member States, coordinated by the Coreper (Committee of Permanent Representatives), and simultaneously the Council consults the European Parliament and where appropriate the Economic and Social Committee. Their opinions may lead the Commission to modify its first proposal.

Council decisions are taken by a simple or a qualified majority vote except for certain cases where unanimity is laid down. This is also necessary where the Council decision is different from the Commission's proposal, although the Commission may itself modify its initial proposal in order to obtain support of the majority.

When the Council has defined the general policy orientation and the basic regulation has been agreed upon, the Commission is responsible for working out its implementation, for its day-to-day management and for surveillance of Community rules. In this legislative task the Commission acts in close cooperation with the Member States through advisory committees of government experts who give opinions on the Commission's proposals. The precise decision-making process tends to vary from case to case; in general, the Commission is not bound to follow the advice it is given and has the power to take decisions, but in some cases the matter may be referred to the Council.

Furthermore, the Commission has established a network of its own advisory committees to receive more generally the views of professional organizations, from traders to producers and from consumer bodies to environmentalists. In specific policy areas, e.g. product sectors in agriculture, there are formal meetings with representatives of producers, processors, traders and consumers.

As regards trade policy, particular provisions were laid down in the Treaty, of which a main feature was the express use of majority voting.[2] This has no doubt contributed to a more rapid and effective decision-making process in this field, a factor that has been recognized by the extension of this practice to other policy areas in the Single European Act. In addition, the consultations with the Parliament are not usually obligatory (except for certain issues in agriculture). Nevertheless, a regular reporting and information process has in recent years been initiated by the Commission.[3]

In the case of negotiations with third countries, a Council decision is required to enter into such a negotiation, usually on the basis of a negotiating directive (which may be more or less specific in nature). Coordination during the negotiation is assured by the Article 113 Committee which gives advice to the Commission as negotiator. This ensures that the necessary decisions or legislation required for implementation of agreements reached with third countries are likely to be approved by the Council once the negotiation is completed. The Parliament is informed of the progress of negotiations.

---

[1] This chapter draws heavily from the reports prepared by the European Community and the GATT Secretariat in the context of the 1991 Trade Policy Review Mechanism.

[2] In the Council votes are weighted according to the size of the Member States, ranging from 2 for Luxembourg to 10 for larger Member States (Article 148 of the EEC Treaty). For their adoption, acts of the Council require at least 54 votes (out of the 76 available) in favour on a proposal from the Commission; or 54 votes in favour, cast by at least 8 Member States, in other cases. Thus, for example, a minority of two large plus one small Member State would be sufficient to block any proposal.

[3] The European Court of Justice has also an impact on trade policy-making through its rulings: examples include the extension of steel crisis measures to import quotas, the conclusion of commodity agreements and its rejection of national tariff quotas (under the GSP system) in favour of a progressively Community-wide system.

1.2. Recent developments and future prospects

1.2.1. The 1992 single market

During the first half of the 1980s the EC economy was characterized by economic stagnation, increasing unemployment, and loss of competitiveness. A fragmented Community market was identified as one of the main reasons for this disappointing performance. This fragmentation of the Community market was caused by the remaining physical and technical barriers between Community countries, restrictive public procurement practices, fiscal differences particularly in indirect taxation (excise duties, VAT) and regulated trade in services (notably financial services).

In 1985, a comprehensive and ambitious approach was launched to revitalize the integration process. Following a Commission initiative, the European Council of 29-30 March 1985 identified as a first priority 'action to achieve a single large market by 1992' and asked the Commission to submit a detailed programme. In response, the Commission presented, on 15 July 1985, its White Paper on completing the internal market. The paper represents a signpost on the way to 1992. It defined the direction and pace of the future development of the internal market. A wide range of physical, technical and fiscal barriers are addressed which are impinging on the free flow of goods, services, persons and capital.

In the absence of common legislation, the principle of mutual recognition comes into play. In this respect, several rulings of the European Court of Justice have paved the way since the late 1970s. Referring to national protection measures and regional quotas, the Commission took the view that their abolition by 1992 was 'not an unreasonable aim'. If so-called Article 115 measures were no longer applicable, any import restrictions would then have to be applied on an EC-wide basis.[1]

While the White Paper did not establish concrete institutional reforms, these were brought about by the Single European Act (SEA) which came into effect on 1 July 1987. The Act lays down the legal basis for the internal market programme. Its creation is evidence of a new momentum in the integration process stemming from the presentation of the White Paper. The Act introduced in the Treaty the 'aim of progressively establishing the internal market' by the end of 1992 (Article 13 of the SEA) and provided for new procedures and practices in the pursuit of issues outlined in the White Paper.

The range of common EC policies and objectives was extended, and institutional changes were made so as 'to ensure smoother functioning of the Communities' (preamble). Thus, for instance, through Article 18 of the SEA, a new Article 100a was inserted in the EEC Treaty which established qualified majority voting for Council decisions on the internal market.

The European Community has made clear that one of the central objectives of the single market programme is that of trade liberalization and the Council has noted that one of the aims of the progress of work to achieve the single market coincides with those of the Uruguay Round, namely to strengthen and maintain the multilateral trading system. This parallel objective of trade liberalization between the Uruguay Round and the single market has placed the European Community's approach to the trade policy aspects of the single market firmly within its long-standing trade policy of open multilateral trade based on the GATT. Community Heads of State or Government have reaffirmed this approach at successive European Councils in declaring that the Europe of 1992 will be an open and partner Europe. The completion of the single European market by the end of 1992 will result in an economic area comparable in size to the economy of the United States of America, creating new trade and investment opportunities both for the Community and its trade partners.

The specific measures required for the removal of physical barriers at the Community's internal borders (e.g. elimination of customs controls on goods) and technical barriers (e.g. harmonization of standards, establishment of a common public procurement market) will have a trade liberalization effect.

The internal market means an area without internal frontiers (Article 8A). Its completion therefore implies the removal of the remaining controls on goods at the internal borders of the Community which impose burdensome and costly restrictions on the flow of goods within the Community. These arise in two principal areas — customs procedures (e.g. import documentation and veterinary controls) and disparities in the Community common commercial policy (e.g. national quantitative restrictions).

The elimination of internal customs procedures will liberalize trade both for Community goods and third country imports into the Community. For example it will mean that third

[1] In a recent communication, the Commission has reiterated that 'after the completion of the internal market it will no longer be possible to use border controls at internal frontiers' to protect national markets. See EC Commission (1990), *Industrial policy in an open and competitive environment.*

country imports will only be subject to one customs import procedure to enter the Community and thereafter can circulate freely within the single Community market without further customs control. The current Single Administrative Document required for intra-Community trade will be abolished. Other customs procedures will be made uniform and simplified within the Community to ensure the free flow of goods throughout the Community.

The necessary completion of the Community's common commercial policy and the elimination of the remaining national quantitative restrictions will also bring a significant liberalization for third country imports. This will eliminate disparities between commercial policy measures applied by Member States and thereby make the conditions prevailing on the markets of individual Member States more uniform. Residual national restrictions, whether or not they have been enforced by the use of Article 115, have to be adapted or eliminated in order to complete the Community's common commercial policy. Already surveillance measures authorized under Article 115 have been reduced from 1 300 in 1987 to 185 in 1991.

The different national industrial standards, legal regulations and testing and certification requirements constitute perhaps the most substantial technical barrier to trade within the Community. The removal of such barriers is therefore crucial both to the completion of the single market and to the realization of its full economic benefits.

The Community approach to removing these technical barriers and creating common European standards rests on two principles: (i) mutual recognition of national rules; and (ii) where appropriate, harmonization of national legislation in cases where these create different levels of protection for the essential requirements of public health/safety, environmental and consumer safety.

This harmonization leads to a significant advantage for producers in that products manufactured in conformity with the resulting harmonized European standard are presumed to conform to the essential requirements. European standards are therefore not being made obligatory, but offer a 'fast track' to the Community market in the regulated sectors. The creation of a common body of rules for regulated product sectors rather than a plethora of different national rules will bring considerable savings and improved access for third countries.

Moreover, where possible, these European standards are based on international standards drawn up by the ISO or IEC. There is, in addition, close cooperation between the European standard-setting bodies, CEN/Cenelec and the international standards bodies of the ISO/IEC. For example draft European standards are made available to the ISO/IEC and, under a recent decision, these European and international standards bodies have agreed to work even more closely together; this includes the adoption of accelerated procedures for the application of international standards as European standards and improved procedures to avoid duplication of work on individual standards.

The total value of government procurement including contracts awarded by firms in the public sector was estimated to represent about 15% of the Community's GDP in 1988, but only 2% of public procurement contracts in the Community were awarded to firms from a Member State other than the Member State advertising the tender. This clearly demonstrates the economic importance of the public procurement market in the Community and the need to create common rules for the establishment of a single public procurement market. The Community has already made substantial progress towards the opening-up of its public procurement market with the adoption of measures on supply contracts, works contracts and 'legal remedies' and the excluded sectors of water, energy, transport and telecommunications. The creation of the Community's public procurement market provides for major trade opportunities for producers inside as well as outside the Community. In addition, the Community is pursuing similar liberalization efforts at the international level in the context of the current negotiations in the GATT government procurement code.

Last but not least, the creation of a single Community market for services, including banking, insurance, securities, transport, telecommunications and capital movements, will generate substantial new trade opportunities. However, the liberalization and deregulation of these services markets will equally provide much improved access to the Community for third countries. As an illustration of the importance of these developments, the new Community banking market will be the largest single banking market in the world.

1.2.2. The Treaty on European Union

The sections of the EEC Treaty concerning the common commercial policy (Articles 110 to 116) underwent only minor modifications under the Treaty on European Union signed in Maastricht on 7 February 1992. Three Articles were dropped (Articles 111 and 114 on transition period, and Article 116 on common action in international economic organizations), while Articles 110 (purposes) and 112 (aid for exports) remained unchanged. Only Articles 113 (content and instruments of commercial policy) and 115 (deflection of trade) were partly redrafted without changing, however, their substance.

The provisions for the establishment of an economic and monetary union in the Treaty on European Union have largely narrowed the possibility for Member States to restrict intra-EC trade in the event of balance-of-payments difficulties. The amended Article 108 no longer makes reference to such a prospect, while under the new Article 109h:2b the Council, acting by qualified majority, may decide upon measures needed to avoid trade deflection where a Member State in balance-of-payments difficulties maintains or reintroduces restrictions against third countries. The provisions of Article 109h:2b, however, concern only the transitional period (stage two), and will cease to apply from the beginning of the third stage of the economic and monetary union.

1.3. Effects of the decision-making process on trade policies

The Community system of taking decisions in the trade policy area is one in which a complex set of checks and balances exists and, in the most usual cases, the result is a network of countervailing forces which can cancel each other out. Thus, in any given situation — such as a decision to apply a safeguard measure, or to put in place the threat of retaliation against a trade partner — there are likely to be opposing views. Some will be in favour of action which is felt to be justified (e.g. by injury to specific interests) and which is desirable to achieve a limited objective, while others will consider that this would be contrary to a more global set of Community interests, would risk escalation of the situation thus affecting Community exports, or is not adequately justified. Decisions are therefore very often the result of hard-fought internal negotiation and ultimately of compromise.

Thus, in a typical case, the Commission is first responsible for analysing the facts, for example as regards injury, and for proposing the measure that is appropriate. Even at this stage there can be difficult internal arguments and disagreements on both the analysis and the solution; but this can also occur within the governmental machinery of any country. The intensity of this argument in the Community case depends on the particular regulation in force since this may impose particular delays for decision-making or other statutory obligations on the Commission services.

At the next stage the pattern often repeats itself, as some form of consultation or other advisory process takes place with the Member States. As indicated above, this can and does lead to divided situations in which those countries with less direct trade interest in the case give more weight to the global interest; those with a wider range of export interests tend to consider more carefully the potential reaction of the third country concerned; those with traditionally a more liberal trade philosophy tend to require a higher standard of impact before resorting to action.

What makes the Community process more complex than that of the ordinary unitary State is that 12 views at governmental level have to be taken into account in addition to the normally opposing views of different sectors of industry and of consumers that might be affected as well as of different government agencies.

Divergences of opinion can continue into yet a third stage. Where the Commission has powers to decide (e.g. in anti-dumping cases or on safeguard action) the rules often provide for the possibility of further review by the Council which must then confirm, reject or modify the Commission decision. In an anti-dumping case, for example, the Commission is able to impose a provisional duty but this decision, after further review of the facts, is later transformed into a definitive duty decision by the Council. In safeguard cases a Commission decision can be (but this is optional) referred for Council review within 90 days.

Where delegated powers do not exist, e.g. for retaliation decisions, the Commission must make a proposal in the normal way to the Council which is then discussed and decided by majority vote according to Article 113. This also can become a protracted process where the spread of views results in two broad camps and where there is no clear majority to proceed or where the minority has a blocking power against decision.

The consequence of these decision-making structures is that, once the basic factual and economic analysis is made, the type of solution to be chosen has to reflect what is acceptable to the qualified majority. The Commission itself will sometimes insist on the proposal which fully applies the basic principles in the Community legislation; but perhaps more often it will look to how this principle can be defended while at the same time seeking the widest support for its proposal. In summary, Community decisions tend to be the product of several internal processes of reconciling divergent views, and to reflect the middle ground of compromise.

The same tendencies and consequences can also be observed in the negotiating positions that the Commission proposes and that the Council adopts; with the additional complication that, since tactical considerations require that the whole negotiating position should not be revealed in public, the Community negotiating directives are very often bland and general. Here another factor enters into play: much of the internal consultation and advisory process in the decision-making is transparent or becomes public very rapidly

and is consequently known to other trade partners at an early stage.

There is also a high degree of transparency as regards the final decision, all regulations and decisions being published as a matter of course. This may have led to perceptions that the Community trade policy is more restrictive than is actually the case. In reality the same degree of transparency does not always exist as regards the measures taken by other countries.

2. The European Community's trade regime

The EEC Treaty enumerates the elements considered necessary for establishing the common commercial policy. According to Article 113, this policy shall be based on uniform principles throughout the Community, notably a common tariff regime, common trade agreements with third countries, and the uniform application of trade policy instruments on both the import and the export sides. Moreover, the Treaty contains the procedural framework for the design of common policies. It thus defines the playing field and sets the general rules of the game. However, the Treaty provides no rules for the conduct of policies, including implementation procedures, in individual trade policy areas. This has been left to subsequent Council legislation.

2.1. Major features of EC trade legislation

The main EC import regulations of a general nature include the Common Customs Tariff (Council Regulation No 2886/89), the Common Rules for Imports (No 288/82), several import arrangements for products from State-trading countries (e.g. No 1765/82 and No 3420/83), the Common Procedures for the Administration of Quantitative Restrictions (No 1023/70), and the so-called New Commercial Policy Instrument (Regulation No 2641/84). Common rules for exports are established by Regulation No 2603/69.

Council Regulation No 288/82 on common rules for imports applies to all products, except agricultural products under a common market organization (including processed products), textiles (MFA products) and ECSC (European Coal and Steel Community) products. Within the product range of its application, it regulates imports from all sources, except imports from State-trading countries. The Regulation starts from the general premise of unrestricted market access. Specific exceptions are enumerated in an annex, allowing for the maintenance of surveillance measures or of quantitative restrictions — the so-called residual restrictions — on the part of Member States. In 1989, the list of products subject to residual restrictions was reduced in scope by three amendments.

The Regulation also provides the legal basis for introducing surveillance measures or imposing quantitative restraints (safeguards) in specified circumstances. In this context, an advisory committee is set up for consultations between Member States and the Commission on possible actions.

The Commission is the competent body for initiating investigations on safeguard measures, when considered justified on the basis of available information. Thus far, it has generally been the Commission's practice to open investigations only at the request of Member States. The decision to engage in an investigation is published in the Official Journal. Affected parties are then entitled to present their views.[1]

The investigation may lead to the introduction of surveillance measures if imports threaten to cause injury to EC producers and if the Community's interests so require.[2] Surveillance can be retrospective. The measures must be of limited duration; Regulation No 288/82 stipulates that they lapse at the end of the second half calendar year after their introduction, unless provided otherwise. Any surveillance action is based on the issuance of an import document.[3] In specific cases, Member States may implement, after having informed the Commission, surveillance measures at the national level.

In cases of urgency, the Commission can immediately impose quantitative restrictions in order to prevent substantial injury or the threat thereof. The provisions of Regulation No 288/82 (Articles 15 and 16) closely follow the wording

1 In many cases, the Commission organizes hearings to which EC and third country producers, importers and exporters are invited.

2 Article 9 of Regulation No 288/82 specifies the information which has to be gathered and examined in this context. In practice, the Community interest is interpreted in terms of the effects of increased imports on production and employment in the affected industries.

3 Surveillance measures under Regulation No 288/82 which are currently in force include video-tape recorders (Republic of Korea), textiles and clothing products (Mediterranean countries), shoes (all third countries; imports from the Republic of Korea and Taiwan are under prior surveillance), and a range of engineering machinery and consumer electronics from Japan. Some of the measures on Japanese imports date back to the early 1980s; they have been prolonged on an annual basis.

of Article 19:1(a) of the GATT.[1] The Community may then either issue import documents of limited periods of validity or change the import rules by instituting prior import authorization.[2] The measure may be confined to imports for certain regions of the EC.[3]

Alternatively, following Article 16 of Regulation No 288/82, the Commission can propose that the Council introduce, on the basis of a qualified majority, safeguard measures. In this case, possible action may take the form of any 'appropriate measures'. This includes the negotiation of restraint arrangements with the exporting country.

On average, the Commission has taken one or two protective measures per year under Regulation No 288/82 since its inception in 1982. The Regulation stipulates no time-limits for the duration of such measures. Furthermore, interim safeguard actions could be taken at the national level if so provided in bilateral agreements between Member States and third countries. Since 1982, this has occurred once.

Imports from most State-trading countries are governed by Regulations No 1765/82 and No 3420/83 (since 1989, however, trade relations with Central and East European countries are regulated by new cooperation or association agreements; see Section 3 below). The former refers to products which, being enumerated in a 'common liberalization list', are not subject to quantitative restrictions. The Regulation specifies, largely in parallel with Regulation No 288/82, surveillance procedures and protective measures to be applied in the event of a surge in imports. Regulation No 3420/83 deals with products which are not liberalized at Community level. It establishes the procedures for administering the import arrangements and for the eventual amendment of these arrangements. A list of import quotas, by originating country and Member State, is annexed.[4]

Council Regulation No 1023/70 lays down procedures for the establishment and the administration of import and export quotas.[5] In principle, quota volumes and criteria for their distribution among Member States are decided by the Council, acting by qualified majority. However, in 1988, the Court of Justice found that the national allocation of quotas is not compatible with the principle of free competition in the common market.[6] At present, Regulation No 1023/70 is not applied.

In 1984, the Community launched its New Commercial Policy Instrument (Regulation No 2641/84). The objectives are to 'defend vigorously the legitimate interests of the Community in the appropriate bodies, in particular GATT, and to make sure that the Community, in managing trade policies, acts with as much speed and efficiency as its trading partners'. The Regulation establishes a procedural mechanism which may be applied (i) to respond to any illicit commercial practices and to remove the injury or (ii) to exercise the Community's rights with regard to third countries' commercial practices. Proceedings may be initiated either by an industry which considers itself injured as a result of illicit commercial practices abroad, or upon request from a Member State. After consulting an advisory committee, the Commission decides on the opening of an examination. The decision is published in the Official Journal.

Regulation No 2641/84 allows for the imposition of any commercial policy measure which is compatible with the Community's international obligations and procedures if, as a result of the examination, such action is considered to be in the interest of the Community. Where international obligations provide for consultations or for dispute settle-

1 There are, however, some differences. Under Article XIX:1 of the GATT, a contracting party is only entitled to suspend obligations if a product is being imported 'in such increased quantities and under such conditions as to cause or threaten to cause injury'. Article 15:1 of Regulation No 288/82 refers to imports 'in such greatly increased quantities and/or on such terms or conditions as to cause or threaten substantial injury to Community producers ...'.

2 Any Member State is entitled to refer the matter to the Council which can confirm, amend or revoke the Commission's decision by qualified majority. In the absence of a Council decision within three months, the measures in question are deemed to be revoked.

3 Commission Regulation No 561/88 may serve as an example of protective measures in favour of certain regions (Member States) and, in this case, against certain trading partners. The Regulations established an import authorization system to protect the Italian and the French markets from footwear originating in the Republic of Korea and Taiwan. The matter was referred to the Council which confirmed these actions. They lapsed on 30 June 1990 and were replaced with an EC-wide export restraint arrangement by both suppliers (Commission Regulation No 1735/90, as amended by Council Regulation No 3050/90). In the case of regional application of protective measures, the Commission, under Article 115 of the EEC Treaty, may authorize the respective Member States to limit transiting imports via other Member States (Section II:5).

4 Before 1 December of each year, the Council has to decide on the quotas for the following year in accordance with Article 113 of the EEC Treaty (by Member State and exporting country). In the absence of a decision, existing quotas will continue to apply.

5 Agricultural products under a common market organization are not covered by this Regulation.

6 The ruling dates as of 27 September 1988 (Case 51/87). While it specifically refers to the regional allocation of GSP (generalized system of preferences) imports, the ruling has general implications. Accordingly, a complete overhaul of Regulation No 1023/70 is currently being considered.

ment procedures, these must have been terminated and their results taken into account before measures are decided upon (Article 10(2)).[1]

Regulation No 2603/69 establishes common rules for exports. It can be seen as the counterpart to the common rules for imports (Regulation No 288/82). Once again, the starting point is the principle of unrestricted trade.[2] In the event of shortages of essential products, the Commission could introduce an export authorization scheme. Such action may be taken on the Commission's own initiative or at the request of a Member State. Any action is subject to consultation in an advisory committee and has to be approved by the Council, acting by qualified majority. As compared with the common rules for imports, Regulation No 2603/69 is less stringent in defining procedures and information requirements.

Without enumerating specific criteria, the regulation stipulates that measures can be limited to exports to certain destinations and from certain regions of the Community. Other provisions provide for export restrictions designed to comply with international obligations, particularly with respect to trade in primary commodities. A general exception clause allows for the application of export restrictions for reasons of public morals and national security, the protection of life and health, the preservation of national treasures and the protection of industrial and commercial property.

Apart from the above regulations of a more general character, there exists a wide range of Council Regulations providing, for example, for remedial action in specific trade situations (dumping, subsidization, etc.) or laying the basis for trade-related policies in areas such as public procurement and standardization. These Regulations are often related to EC obligations under the Tokyo Round Agreements.[3]

2.2. Tariff measures

The Common Customs Tariff (provided for by Article 9 of the EEC Treaty) was among the first tangible signs of the European Economic Community. The establishment of the Common Customs Tariff (CCT) demanded harmonization of the sometimes widely differing tariff levels of the individual countries establishing the Community. New Member States acceding at a later stage have harmonized their own tariff to the CCT over a transitional period.

Article 113 of the EEC Treaty transfers the competence to enter into tariff and general trade policy negotiations with third countries from national to Community level. It is thus the European Commission which represents the Community in bilateral as well as multilateral trade negotiations.

The conventional duties applied are those customs duties applicable to goods or imported products originating in countries who are GATT contracting parties or with whom the EEC has concluded agreements granting them the most favoured nation (MFN) clause with regard to tariff matters. However, the Community applies conventional duties to goods imported from any third country. Autonomous duties are applicable in (those relatively few) cases where they are less than the conventional duties or where no conventional duty exists (as for a wide range of agricultural products).

The Council may authorize total or partial suspension of autonomous duties over a determined period in cases where the production of goods in the Community is insufficient or non-existent. The system of tariff suspensions may be associated with a system of quotas; the fixing of quotas is shared between Member States (to be revised according to the 1992 rules).

All imports into the Community are subject to duty or duty-free entry in accordance with their classification in the EC Harmonized Tariff schedule comprising some 9 500 tariff lines. Nearly all duties are *ad valorem*. The weighted average of tariffs on all EC imports was 5,7% at the outset of the

[1] To date, the instrument has been used twice, in the so-called Akzo-Dupont case concerning Section 337 of the United States Tariff Act of 1930 and in a case concerning sound recordings in Indonesia. Section 337 of the United States Tariff Act has been subject to a GATT Panel. The report of the Panel was adopted by the GATT Council on 7 November 1989. As for sound recordings (Indonesia), the Commission decided to terminate the investigation after a solution was found between the authorities involved. There have been two other cases involving Regulation No 2641/84, where the complaints of EC companies were rejected by the Commission. The issues were soybean oilcake (Argentina) and new polymorph (deprivation of patent protection; Jordan). Recently, Italian tomato canners who have been affected by the United States countermeasures against the EC hormone ban submitted a formal complaint. The EC is currently examining whether action under the New Commercial Policy Instrument, in particular a request for a GATT Panel, is called for.

[2] By a later amendment (Regulation No 1934/82), a list of product-specific exceptions from the common rules at the EC-level was replaced by individual lists of exceptions on the part of some Member States. The only EC-wide exceptions from the basic freedom to export principle which are still in force apply to petroleum oils and gases. The Council, by qualified majority on a Commission proposal, can include any of these products under the common rules. In practice, most of the exceptions provided for by Regulation No 1934/82 are actually not being applied. Their partial or complete elimination is currently under consideration.

[3] The European Community has signed all Tokyo Round Agreements. Three Member States have not yet assumed obligations under the GATT Code on Government Procurement.

Uruguay Round and the unweighted average came to 6,5%. Tariffs for industrial products are lower and more evenly spread across tariff items than tariffs for agricultural products. Nearly all EC imports (99% of imports from MFN sources) enter under 'bound' or partially bound tariffs. Tariffs on 92% of all items are fully or partially bound.

Developing countries benefit from the Community's generalized system of preferences (GSP) or from one of the even more favourable preference arrangements (the Lomé Convention or bilateral agreements and arrangements). Imports of industrial products and of certain agricultural products from the EFTA countries enter duty-free into the Community in accordance with the Free Trade Agreement between the individual EFTA countries and the Community (see Section 3.1 below).

Exports from the Community are essentially unrestricted. However, as mentioned above, some product-related exceptions can be applied to prevent supply shortages of essential products, for reasons of national security, for protection of life, health and the environment or to protect national treasuries. Export promotion activities take place mainly at national level, but the Community has in recent years become increasingly involved in this area.

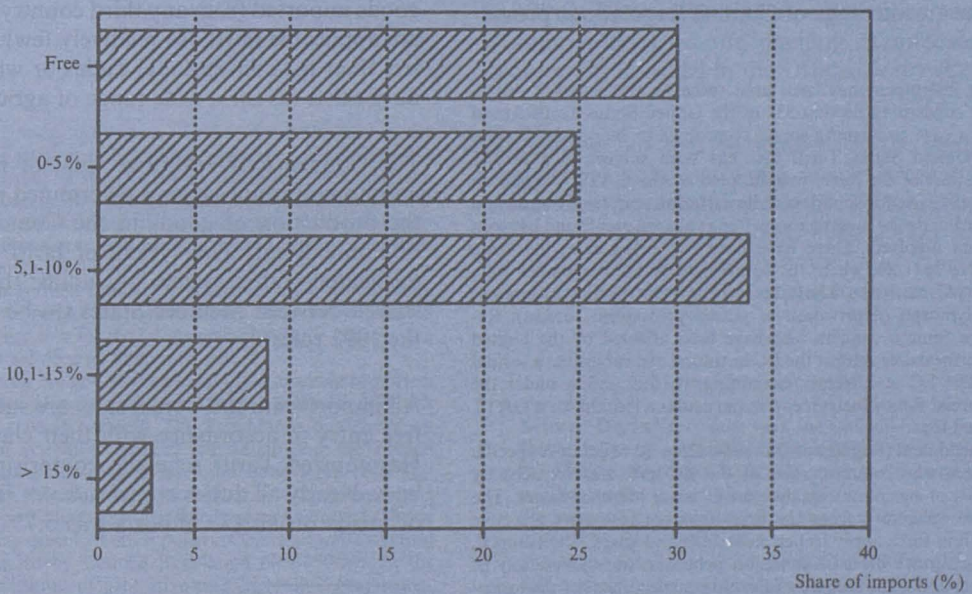
2.3. Other trade-related measures

2.3.1. Barriers to intra-EC trade and quantitative restrictions

The common commercial policy is a centrepiece of the EEC Treaty. Basically, it refers to policies which are decided upon and implemented at the EC level (e.g. tariffs, anti-dumping and countervailing measures, most quantitative restrictions). In addition, there is a number of trade-related policies which lie, more or less, within the competence of Member States. In many cases, this competence is limited by the EEC Treaty and the Commission exerts supervisory powers. Examples include State aid and public procurement activities.

Individual Member States have been applying certain quantitative restrictions against imports from third countries. Most of these measures, the so-called residual restrictions, pre-date EC membership; they are largely confined to certain sensitive sectors. In principle, any national restriction (including quotas under the Multifibre Arrangement (MFA)) is liable to circumvention by intra-EC transits. To fend off such indirect imports, Member States can request the

GRAPH 35: **Distribution of EC imports from MFN sources by range of tariff rates**
(All products, 1988)



Source: GATT Tariff Study, Report by the GATT Secretariat, TPRM, March 1991.

Commission's authorization to temporarily intervene at internal frontiers and to suspend certain products from Community treatment (Article 115 of the EEC Treaty). The record of individual Member States and sectors under Article 115 is suggestive of gaps in the common trade policy regime and indicates some of the problem areas in the integration process.

The Commission determines the conditions and details of measures under Article 115. In 1979 and 1987, it issued decisions with a view to tightening the general criteria for authorizations. Referring to the establishment of a common commercial policy and to the single market objectives, the Commission stressed that these measures should be applied 'only for a limited period and where the gravity of the situation so warrants' (Commission Decision 87/433).[1]

The duration of individual applications is decided on a case-by-case basis, ranging from two months up to one year.[2] For textiles, authorizations are only granted if national quotas of Member States are exceeded by at least 50% and, in general, the amount in free circulation exceeds the quota by more than 100%. Reflecting the focus of the external trade measures which it is intended to support, Article 115 has never been applied on an *erga omnes* basis.

In order to achieve uniformity of its trade regime, the Community has followed a policy based on the progressive elimination of those quantitative restrictions that had been traditionally applied by its Member States (in many cases prior to their accession to the Community). This principle of liberalization is indeed reflected in the two instruments of commercial policy dealing with quantitative restrictions (Regulation 288/82 and Regulation 3420/83; see Section 2.1). Restrictions maintained by the Member States are listed as exceptions to such principles and these lists have been progressively reduced over time.

The accession of Portugal and Spain to the European Community illustrates the effects of membership on the elimination of quantitative restrictions. As an example, in the case of Spain, out of a total of 430 quantitative restrictions, the Treaty of Accession envisaged the elimination of 328 either immediately or at the end of a transitional period.

By July 1992, the number of surveillance measures authorized by the Commission under Article 115 had dropped to three. This compares with 800 surveillance measures authorized in 1988. Likewise, the number of intra-EC trade restrictions in force dropped from 128 in 1988 to only three in mid-1992. Most of the restrictions used to be concentrated in four Member States, namely France, Spain, Italy and Ireland. By contrast, Germany has not taken any action under Article 115 since 1984. From a sectoral perspective, the huge majority of restrictions has been imposed on imports of textiles.

The transition of Central and East European countries towards market economies has resulted in the near total elimination or suspension of the quantitative restrictions affecting their exports to the EC market. The recently signed Association Agreements have further improved access to the Community market (see Section 3.2).

Since 1989 the question of specific quantitative restrictions applied to products originating in Japan has been the subject of bilateral consultations. Two liberalization packages were implemented in July 1989 (Regulation 2429/89) and November 1990 (Regulation 3156/90). The recent arrangement on automobiles has allowed the progressive relaxation of the restrictive measures on the Italian, Spanish and Portuguese markets.

The completion of the internal market will have major implications for the maintenance of national quantitative restrictions. Disparities in national import regimes, which have in the past been enforced by means of measures applied under Article 115 of the Treaty of Rome, are incompatible with the objective of eliminating all barriers to the free circulation of goods within a large unified market. With the abolition of internal frontiers national measures will not be implementable as from 1 January 1993. It is in this context, that the Commission has acted to bring the number of authorized measures down to a virtual disappearance.

[1] Decision No 87/433 establishes a two-tier approach: (i) On the basis of Article 2 the Commission can authorize the issuance of an import document for surveillance purposes 'where there is a danger that imports into a Member State ... will give rise to economic difficulties'. As a general rule, such action should be limited to cases where 'significant imports' via other Member States have been made in the preceding year and/or the Communities' imports of the product in question from the originating country exceeded 1% of its total third country imports. (ii) In case of actual difficulties, Member States may apply for protective measures (Article 3). They are then required to provide, *inter alia*, the following information: direct imports and detouring imports from the third country concerned; imports from other third countries with which similar arrangements are being maintained; total third country imports; imports originating in the Community. Other Member States are informed of the request.

[2] However, by way of subsequent authorizations these measures may be prolonged over several years. For example, Article 115 measures have been in place for TV sets and radios since 1974 (France, Italy), for cars since 1981 (Italy) or 1986 (Spain) and for motorcycles since 1986 (Italy and Portugal). In the case of requests for the prolongation of measures under Article 115, the same procedures and criteria are applied as with any original authorization.

2.3.2. Safeguard actions

Article XI of the GATT bans the use of quantitative restrictions as a trade policy instrument. However, this obligation is subject to a few precisely-defined exceptions under Article XIX. Safeguard measures can be imposed when an industry is seriously injured or threatened with injury by foreign imports. The requirements needed to impose a quantitative restriction are an increase in the import volume, the extent of the price-undercutting and the consequent impact on EC producers. The threshold of injury for safeguard measures is usually higher than in anti-dumping cases. There must be a casual link between the volume and conditions of imports and the serious injury. Protection must be limited to the duration and extent necessary to prevent or remedy the injury. The EC must give written notice which is followed by consultations with the affected export country. With the exception of agricultural products covered by market regimes, safeguard measures taken by the Community are usually based on Council Regulation No 288/82 relating to common rules for imports or under Regulations 1766/82 and 3420/83 relating to the common rules for imports from State-trading countries. In addition, safeguard measures are provided for in a Regulation dealing with trade with China and in each preferential agreement implemented by separate Regulations.

Proceedings under Council Regulation No 288/82 may lead to export restraint arrangements, although the latter are not expressly foreseen in the Regulation itself. Upon termination of an investigation, and before taking safeguard measures, the Commission holds a disclosure session. The exporting country is informed about the findings of the investigation and given the opportunity to offer an appropriate restraint arrangement. Member States are then asked to approve the envisaged solution.

Restraints are usually agreed for a three-year period, with degressive application over time. Main product areas concerned include textiles, steel, machinery, consumer electronics, and motor vehicles. Protective actions under Regulation 288/82 tend to be confined to a limited number of Member States, but in 1990 EC-wide measures were introduced for the first time.

2.3.3. Anti-dumping and anti-subsidy actions

The Community's anti-dumping rules were adopted in accordance with existing international obligations, in particular those arising from Article VI of the GATT and the 1979 Anti-Dumping Code. In applying these rules the Community seeks to maintain the balance of rights and obligations laid down in Article VI and the Code. It also takes account of the interpretation of these rules by its major trading partners.

The EC basic legislation is Council Regulation No 2423/88 and, as far as coal, iron and steel products are concerned, Commission Decision No 2424/88. Complaints about dumped (or subsidized) imports can be lodged either directly with the Commission or via Member States.[1] After consultations within an advisory committee, including representatives of Member States under the chairmanship of the Commission, the latter decides upon the initiation of proceedings which are then carried out under its own responsibility. The initiation is announced in the Official Journal. Interested parties have a right to be heard and to express their views at different stages of the proceedings, after the initiation of the procedure and the introduction of provisional measures.

The Council Regulation stipulates that an investigation shall normally be concluded within one year; it shall normally cover a period of not less than six months immediately prior to its initiation. In accordance with the GATT provisions, both the imposition of provisional duties and of definitive duties are contingent upon the establishment of dumping (either by a preliminary examination or a final finding) and of injury caused thereby. In addition, EC legislation stipulates that measures may only be taken when the interests of the Community call for intervention.[2]

The Commission is empowered to impose provisional duties during the proceedings, to accept price undertakings, or to terminate proceedings when no evidence of dumping or injury could be established. If a Member State disagrees with the decision by the Commission the matter is referred to the Council; if the latter does not decide to the contrary within one month, the Commission's proposal will take effect. The introduction of definitive duties is decided by the Council (qualified majority) on the basis of a Commission proposal.

As a rule, the Commission imposes provisional duties only after the preliminary finding of dumping and injury, provided that no price undertakings are agreed upon. The validity of provisional duties is limited to a period of four months which may be extended by an additional two months in certain circumstances.

---

1 The initiative may be taken by any natural or legal person or any association acting on behalf of an EC industry, which considers itself injured or threatened with injury. In the absence of such complaints, Member States may directly communicate to the Commission any evidence of dumping or subsidization.

2 This applies both to the imposition of provisional duties (Regulation No 2433/88, Article 11:1) and of definitive duties (Article 12:1).

Dumping margins are defined as the difference by which the normal value of the product concerned (e.g. in the exporter's domestic market) exceeds the export price. To obtain representative results, normal values are usually established on the basis of weighted averages for a certain time-period. When no like products are sold domestically in the ordinary course of trade or when such sales do not permit a proper comparison, a constructed value is taken in most cases. The constructed value includes all production costs, 'a reasonable amount' for selling, administrative and other general expenses, plus the average profit realized by the producer or exporter on the profitable sales of like products on the domestic market.

As regards export prices, Council Regulation No 2423/88 provides either for the use of actual prices or of constructed prices. The latter may be established when no export prices exist, when exporters and importers are associated, or when actual prices are considered unreliable for other reasons. In general, prices are constructed on the basis at which the products are first re-sold to an independent buyer. Allowances are then made for all costs incurred between importation and resale and for a reasonable profit margin. These components are excluded from the export price used in the determination of dumping margins. A dumping margin is calculated for each transaction. In establishing the average margin, transactions where export prices were above the normal value (involving 'negative dumping margins') are treated as if the price difference was zero.

To prevent the circumvention of definitive duties by assembly operations, the EC anti-dumping instrument also relates to operations on the basis of imported parts and components (the so-called 'screwdriver plant legislation'). Under certain conditions, anti-dumping duties can be extended to products which were produced or assembled within the Community on the basis of imported inputs.[1]

As a general rule, EC anti-dumping and countervailing duties lapse after five years (sunset clause). The date of expiry is published in the Official Journal in advance and, in addition, made directly known to the EC industry concerned. The latter has the opportunity to show that the expiry of the duties would lead again to injury or threat thereof. After consultation with Member States, the Commission can reopen an anti-dumping or countervailing duty investigation.

Between 1980 and 1990, 400 cases were initiated in the Community and 900 decisions were taken.[2] Over such a period, the number of cases resulting in definitive duties or price undertakings has been on average about 14 per year, with some fluctuation from year to year. In 1991, of the 79 investigations in progress, 21 ended with the imposition of definitive duties or price undertakings (see Table 81). A large number of complaints lodged by Community industry do not lead to the initiating of a procedure. It is estimated that nearly half of all complaints fall within this category.

When looking at the impact of anti-dumping measures a number of qualifications need to be taken into account. First, the amount of the anti-dumping duties imposed is not automatically the same as the amount of the dumping margin established; when the injury caused by the dumped imports is less than the dumping margin, the amount of the measure will be limited to what is adequate to remove the injury. In the period from 1985 to 1990 the amount of the anti-dumping duty was, in nearly 50% of the cases, limited to the 'injury threshold'. Secondly, a large number of anti-dumping investigations in the Community are terminated with the acceptance of price undertakings.[3] This is consistent with the remedies permitted by the GATT Code, even if the Community has made more use of price undertakings than other signatories. During the period 1985 to 1990 nearly 50% of the investigations were terminated by this type of measure.

As for anti-subsidy actions, the number of proceedings initiated has been relatively small, and only seven measures have been taken between 1980 and 1991. They concerned imports of shoes from Brazil, steel from Spain (before becoming a member of the Community) and Brazil and, more recently, ball bearings from Thailand and polyester fibres and yarns from Turkey.

[1] The party must be related to or associated with a manufacturer whose imports are subject to a definitive duty; the operation must have been started or substantially increased after the opening of the investigation; and the value of inputs used from the country of exportation must exceed 60%.

[2] The number of decisions is greater than the number of cases initiated because any case may concern several countries or exporters for each of which a decision is required.

[3] A price undertaking is a binding commitment from an exporter to raise export prices so that either the dumping or the injury suffered from the dumped imports by the domestic industry is eliminated. A price undertaking will be accepted only after a full investigation, after the exporter has had the opportunity to fully exercise his rights of defence and after a determination of dumping and material injury has been made. A price undertaking is often the outcome of an anti-dumping procedure preferred by the exporter, because it enables him to maintain his commercial relationship with his importer and a share of the market.

Table 81

EC anti-dumping and anti-subsidy investigations (1 Jan. 1987-31 Dec. 1991)

	1987	1988	1989	1990	1991
Investigations in progress at the beginning of the period	21	39	53	60	59
Investigations initiated during the period	39	40	27	43	20
Investigations in progress during the period	60	79	80	103	79
Investigations terminated by:					
imposition of definitive duty	9	18	10	18	19
acceptance of price undertaking	8	—	5	9	3
determination of no dumping	—	—	—	—	1
determination of no subsidization	—	—	—	—	—
determination of no injury	4	5	5	13	6
Terminated for other reasons	—	3	—	4	4
Total investigations concluded during the period	21	26	20	44	33
Investigations in progress at the end of the period	39	53	60	59	46
Provisional duties imposed during the period	31	28	10	23	19

Source: Tenth annual report from the Commission to the European Parliament on the Community's anti-dumping and anti-subsidy activities, SEC(92) 716, 27.5.1992.

2.4. Trade policies in selected sectors

2.4.1. Agriculture

Agricultural policy is included in Part Two of the EEC Treaty ('Foundations of the Community') and has often been regarded as one of the institutional cornerstones of the Community. The objectives of the common agricultural policy (CAP) are set out in Article 39 of the Treaty: (a) increasing agricultural productivity; (b) ensuring a fair standard of living for the agricultural community; (c) stabilizing markets; (d) assuring the availability of supplies; and (e) ensuring that supplies reach consumers at reasonable prices.

Since the early 1960s three main stages can be distinguished in the Community's agriculture. The initial decline in production deficits; secondly, in the 1970s, a transition to self-sufficiency and to a net exporting position for a number of major commodities; and finally, in the 1980s, the emergence of disequilibria between supply and effective demand.

The change in the net trade position was accompanied by the progressive declining share of agriculture in total production and employment: the former fell to 4,6% in 1988 from 8,4% in 1960, while in terms of employment the corresponding drop was to 7,4% from 21,1%. Rapid increase in agricultural productivity linked to structural and technical improvement in the sector, the labour flow from agriculture to expanding industries, and low growth of demand for agricultural products have been major factors behind the contraction in the relative size of the Community agriculture.

The EC agricultural policy is generally formulated by the Agricultural Council, attended by Ministers for Agriculture. The Council sets the broad thrust of policies on the basis of Commission proposals, while the fine tuning is to a large extent left to the Commission. The management of the markets is carried out in close cooperation with agricultural specialists from Member States within the framework of so-called management committees.[1]

More than 80% of EC agricultural production is subject to common market organization. The bulk of production is covered by intervention mechanisms based on internal price support underpinned by *ad valorem* customs duties, variable levies (specific duties), and a system of minimum prices,

[1] In addition, regular consultations are held at the national and EC levels with organizations representing farmers and farm workers, processors and workers in the processing industries, traders, agricultural credit organizations and forest owners. Twenty advisory committees, four special sections and four joint working parties meet regularly during the year to discuss matters of interest at Community level. The consumers' organizations also take part in these meetings.

compensatory taxes, and export subsidies. These measures are designed to support farm incomes, by making them less dependent on world market trends. Supply controls have also been added to the system over time.

Tariff quotas are also used, and preferential access is granted for products originating from EFTA, ACP and Mediterranean countries, and in the framework of the GSP scheme. For products for which there is no or insufficient production in the Community, total suspension of tariff may also be authorized by the Council. Certain agricultural products may also benefit from a favourable import tariff regime depending on their specific destination (Regulation No 4142/87).

Agricultural levies are established on the basis of weighted average values calculated for the relevant agricultural products. In general, the levy for a particular agricultural product is equal to the difference between a predetermined entry price and the value on the world market for the corresponding product. Agricultural levies are, therefore, specific duties, which can be applied individually, or in combination with *ad valorem* duties, to which certain categories of agricultural products and their derived processed products are subjected. For agricultural imports from third countries offered at prices considerably lower than those at which Community production can be sold, tariffs are established through the fixing of minimum import prices and compensatory taxes, calculated on the basis of the prices applied by the supplying countries.

As a result of the various import arrangements, about 55% of the Community's agricultural imports come in duty free; almost 34% are subject to customs duties or to a combination of customs duties and levies or countervailing charges; and 11% of total Community imports are subject to a levy. The Community remains the world's largest importer of agricultural produce and foodstuffs, well ahead of the United States of America and Japan in terms of share of world trade.

Export refunds are meant to cover, as far as possible and in such a way as to allow export on the basis of the prices in international trade, the difference between these prices and the (higher) Community prices. Export refunds move in line with changes in the world market price. The refunds system applies to cereals, fruit and vegetables, rice, sugar, isoglucose, tobacco, beef and veal, pigmeat, poultrymeat and wine. It also applies to cereals, rice, milk and milk products, eggs and sugar exported in the form of certain processed goods not covered by Annex II to the EEC Treaty (as set out in Annex B to Regulations Nos 2727/75 and 2418/76 on cereals and rice, and in the Annex to Regulations Nos 2771/75, 3330/74 and 804/68 on eggs, sugar and milk respectively).

In general, refunds are fixed at regular intervals by the Commission, in accordance with the management committees procedure. If the need arises, the Commission may, at a Member State's request or on its own initiative, change the refunds in the intervening period in order to react quickly to changes in the data which formed the basis for its calculation. In certain sectors, and subject to certain conditions, the refund is fixed by tendering procedure. In view of the mobility of refund rates and the need for operators to know in advance the relevant price levels, particularly in the case of long-term contracts, the refund can be fixed in advance for certain products. The rate of the refund may be differentiated on the basis of the kind and quality of the product and its destination (to take account of the transport costs or the conditions in import markets).

The rules for applying the refund system have been the subject of provisions common to all the sectors under Regulation No 3665/87. Furthermore, arrangements for the advance financing of refunds, also common to all sectors, were introduced (payment of the refund in the event of warehousing for export and in the event of processing under temporary import procedure).[1]

In recent years, for major agricultural products such as cereals, dairy products and beef, subsidized exports have replaced intervention storage as the main tool for regulating the EC markets. These three groups of agricultural products account for the bulk of export refund expenditure in the Community, with cereals and dairy products each accounting for some 30%.

Import and export licences and certificates were introduced under each common market organization. They are subject to common arrangements (Regulation No 3719/88) but the sectoral regulations may lay down specific rules for applying these arrangements, concerning in particular the period of validity of the licences and certificates and the level of any security deposit. Import and export licences have a triple aim: they are documents which forecast trade, instruments for administering the protective measures, and, where appropriate, instruments for the advance fixing of levies and refunds. Advance-fixing certificates perform only this third function.

The import and export of certain products is subject to the presentation of import and export licences. For some other products, it is either import or export which is subject to presentation of a licence. Production of an advance-fixing

[1] Regulation No 3665/87 describes certain procedures to be observed by all exporters wishing to receive an export refund, and also the methods of paying the refund.

certificate is always optional; it is compulsory only in cases where the operator wishes to benefit from the provisions relating to the advance fixing of levies or refunds. The period of validity of the licences and certificates varies from one product to another. Licences and certificates are valid throughout the Community, irrespective of the Member State of issue.

Import and export licences confer the right to import and export respectively on the basis of the licence, under certain conditions, where appropriate with advance fixing of the levy or refund. The only effect of advance-fixing certificates is to enable the operator to benefit from the fixing in advance of the amounts indicated. The rights arising from the certificates are transferable by the holder of the certificate, for the period of validity of the certificate.

The licences impose the obligation to import or export the net quantity of the product indicated during the period of validity of the licence, failing which the security lodged is forfeited. Regulation No 3719/88 describes, *inter alia*, the conditions and procedures for issue of licences, the use made of them, the verification of licences and release of securities.

In the early 1980s the Community made extensive changes to the common agricultural policy, including a restrictive price policy, producer co-responsibility, easing of the role of intervention, the diversification and strengthening of socio-structural measures. This reform was carried out mainly in response to the Community's own preoccupations. The objective sought was largely to restore a better balance to the agricultural markets, to promote the development of Community agriculture on a sound economic footing, and at the same time to ensure rational use of the available budget resources.

Under this reform, the Community implemented a relatively wide range of instruments aimed directly or indirectly at limiting agricultural supply or preventing it from increasing too fast. These measures fell into two main categories: (i) measures affecting the support price, as a determining factor in farmers' choice of production; and (ii) measures affecting the quantities produced, either by limiting the quantities or by limiting one of the factors of production used (e.g. the land). As support prices were reduced, the mechanisms for intervention buying-in by public bodies were made more flexible in order to ensure that the market played a larger role. The second type of measures involved production quotas and the set-aside of land. From the inception of the CAP, production quotas were applied to sugar, production of which has remained relatively stable during the second half of the 1980s.

The introduction in 1984 of a system of production quotas for milk, followed by the reduction of the reference quantities, led to a major restructuring of the Community milk market. In 1988, the Community also introduced a voluntary system for the set-aside of arable land, under which producers taking part received compensation for loss of earnings.

Despite the partial results obtained through this reform, certain markets were still suffering an imbalance or looked likely to do so. The problem of surpluses had not been solved on a lasting basis, and only fairly small-scale use had been made of back-up measures such as set-aside, extensification, and the system of income support. That is why the Community underwent a lengthy internal discussion to provide a new direction to the CAP.

In May 1992, the guidelines for a major reform of the CAP were approved by the Council of Ministers. The reform was the response to the uncertainties arising from several years of increasing production surpluses and budgetary constraints. It aimed at a better orientation of agricultural production in the Community, while taking into account other objectives, in particular those related to the environment, the farmers' revenue and the local rural economies. The first Regulations for the implementation of the reform were adopted on 30 June 1992. The full implementation of the Council decision will take place over the period 1993-96.

The CAP reform still relies on the existence of a common price mechanism, a common external protection (variable, with floor or reference prices), and intervention buying-in by public bodies. But the policy mix has been substantially modified. The reform is based on three main orientations, as originally proposed by the Commission: (i) a substantial price reduction, to make prices more competitive on the internal and external markets; (ii) a full and lasting compensation of the negative effects of such price reduction, with direct income support, decoupled from production, to farmers; and (iii) measures limiting the use of certain factors of production (as in the case of set-aside schemes), together with stricter rules in terms of production quotas for certain products. At the same time, action will be taken to protect the environment, and to favour the early retirement of aged farmers and non-agricultural uses of land.

With the reform, price support will no longer be the only instrument to sustain Community agriculture, and direct income support will play a major role. The growth of production will depend more closely on actual market perspectives. Furthermore, by modifying at the root its internal rules, the Community has shown its willingness to contribute to the effort to liberalize international agricultural trade.

2.4.2. Textiles and clothing

The Community maintains a number of bilateral agreements, and in other cases has agreed administrative cooperation concerning textiles, with signatory countries of the Multifibre Arrangement (MFA), as well as with Mediterranean, Central and East European countries in the framework of economic cooperation or association agreements. At the same time, the Community maintains some autonomous restrictions *vis-à-vis* non-GATT contracting parties and State-trading countries.

The internal legal basis for the application of the present textile import regimes are Council Regulations on common rules for imports of certain textile products originating in third countries. Agreements with third countries are negotiated on the basis of a Council negotiating directive, assisted by Member States within the Article 113 Committee.

The Commission administers the bilateral textiles agreements and arrangements, assisted in this task by a Textile Committee composed of representatives of the Member States and chaired by a Commission representative.

The Community is a signatory of the Arrangement regarding international trade in textiles (MFA) and has accepted the 1986 Protocol extending the Arrangement to July 1991, and its further extension to 31 December 1992. Within the framework of MFA IV, the Community negotiated, in 1986, 19 bilateral agreements with restraints on the imports of textile products. These agreements are aimed at providing for an orderly and equitable development of trade in textile products on the basis of bilateral cooperation, with a view to eliminating the situations of market disruptions or real risk thereof. These agreements provide for quantitative limits and for a basket exit mechanism applicable to supplier countries' exports under specified circumstances. The Community has undertaken the commitment to refrain, in respect of products covered, from introducing quantitative restrictions under Article XIX of GATT or Article III of MFA. These bilateral agreements expired on 31 December 1991 and have been extended for the year 1992, pending the outcome of the Uruguay Round.

There are substantial differences among the agreements as to the number of restrained categories. In the case of large suppliers, there are up to 40 restrictions. In the case of smaller suppliers, there can be only one or two restrictions. The Community quantitative limits are allocated among the Member States. There are also cases where individual quantitative limits for single Member States are applied without a Community limit. With six other countries there are agreements, or exchange of letters on textiles, with no restraints.

In the framework of the preferential economic cooperation or association agreements with Mediterranean countries, a system of arrangements for administrative cooperation has been set up by which the exports of certain categories of textiles and apparel products to the Community are closely monitored. The aim is to avoid export increases of certain sensitive products causing disruptions in the Community market. Should this occur, safeguard measures provided for in the preferential economic cooperation or association agreements would have to be invoked. Administrative arrangements for trade in textiles exist with Turkey, Egypt, Morocco, Tunisia and Malta. They generally have a duration of 2 or 3 years.

The recent association agreements concluded with certain countries in Central and Eastern Europe contain textile protocols setting the treatment accorded to their export to the Community. The previous bilateral agreement with the ex-Yugoslavia has been replaced by an autonomous regime pending the clarification of the political situation.

The Community distinguishes 161 categories of textile and clothing products, based since 1988 on the Combined Nomenclature, of which categories 1 to 123 are the object of the EC textile policy. In total, by the end of 1990, the Community had 26 bilateral MFA-type agreements with Bulgaria and the USSR, and five administrative cooperation arrangements with Mediterranean countries. Four of the agreements are in the form of an exchange of letters: they do not provide for either restraint levels or for the possibility of introducing them. Two agreements do not provide for restraint levels, but provide for the possibility of introducing some restraints in the case of real risk of market disruption.

On the basis of Regulation No 3420/83 ('autonomous regime') certain textiles and clothing imports from State-trading countries are subject to quantitative restrictions at Member State level. Quotas relating to these restrictions are authorized through Community procedures on a yearly basis. In some cases of countries having concluded an MFA, or MFA-type, textile agreement with the Community, this 'autonomous' regime applies only to categories not covered by the bilateral agreements and to outward processing trade. Following negotiations with Central European countries (Poland, Hungary, Czechoslovakia, Bulgaria, Romania) OPT quotas have been incorporated into the bilateral agreements.

In 1988, two-thirds of imports from countries with MFA agreements were imported under bilateral quotas, while the remaining third came in free of any restrictions. For preferential countries, 79% of imports were in categories under

surveillance and one-fifth with no monitoring. Combining the cases of bilateral and autonomous restrictions with surveillance in preferential arrangements (although the difference between the two is substantial) the global picture at the beginning of this decade was the following:

(i) only about half of all imports entered the Community under some sort of quantitative limitation (or preferential surveillance);

(ii) about one-quarter are subject to the basket exit mechanism, but are not restricted;

(iii) about one-quarter of the Community's total imports of MFA products are not covered by any form of arrangement. They come from industrialized countries and other unrestricted sources like ACP countries, Gulf countries and other smaller supplier countries not covered by any form of arrangement.

As compared to the previous agreements concluded in the framework of MFA III, the agreements concluded under Article 4 of the MFA since 1986 reflect a more liberal stance of the Community trade in textiles. One-quarter of all previous quantitative restrictions were removed. All margins for either category transfers, carry-overs and cumulative application of flexibilities were greatly enhanced and new facilities for inter-regional transfers and optional conversion of quotas for children's garments were introduced. All new limitations were the result of negotiations with the supplier countries and no unilateral actions were taken.[1]

The Community is the largest importer of textiles and clothing in the world. Both imports from MFA countries and from other countries have increased considerably, as a whole, since 1976. Notwithstanding the decreasing average value of imported goods in latter years, the gap between EC exports and imports reached almost ECU 8 200 million in 1990 and ECU 12 600 million in 1991. As a consequence of the very fast increase of shipments from MFA countries, the share of the latter reached almost 60% of total EC imports in volume.

[1] Categories which are not restrained are subject to the so-called 'basket exit mechanism'. When imports from a given country reach a specified share of total imports, consultations may be held with a view to introducing mutually agreed limitations. The 'trigger levels' vary across five groups of countries and three product groups. Community action requires the prior assent of Member States to a Commission proposal in the context of the EC Textile Committee.

3. Trade agreements and preferential trade schemes

3.1. The European Economic Area (EEA)

The institutional links between the Community and EFTA countries have been largely determined by institutional changes in the Community itself. When Denmark and the United Kingdom (former members of EFTA) joined the Community in the early 1970s, the Community concluded Free Trade Agreements with the individual EFTA countries. The elimination of tariffs and quantitative restrictions in industrial goods envisaged by such agreements averted the imposition of tariffs by Denmark and the United Kingdom *vis-à-vis* the remaining EFTA members.

The move towards the completion of the internal market coincided with new efforts to intensify the cooperation between the Community and EFTA, and led to the creation of the European Economic Area (EEA). Negotiations were concluded on 14 February 1992 and the Agreement was signed on 2 May 1992. After ratification by national parliaments of the Community's Member States and of the EFTA States, and by the European Parliament, the Agreement is expected to come into force on 1 January 1993. Main objectives of the Agreement, as stated in the EC Council's negotiation directives for the Commission, are (i) free movement of goods, services, capital and persons throughout the EEA on the basis of the relevant EC *acquis communautaire*, by 1 January 1993; (ii) strengthened cooperation in the framework of Community actions in other areas; (iii) reduction of regional and social disparities; and (iv) a surveillance procedure including a mechanism for dispute settlement.

The free movement of industrial goods and processed food products in the strengthened Free Trade Area is subject to simplified rules of origin,[2] as well as mutual recognition and harmonization of technical standards. The Community and the EFTA countries are committed not to impose anti-dumping actions *vis-à-vis* each other, while maintaining autonomous policies in this field. In addition to the rules on State aids and antitrust policy, the Agreement establishes the criteria for the cooperation between the two parties in the area of competition policy.

[2] Fewer and simpler documents will be needed to prove the origin of goods; the principle of cumulation will apply; alternative percentage rules will present an easier way of calculating the origin of goods; and a general tolerance rule will reduce formalities by allowing for a certain margin of error in the calculation of a product's origin.

3.2. EC trade regimes towards Central and Eastern Europe

Until the late 1980s, the Community rules on State-trading countries placed the countries of Central and Eastern Europe at the bottom of the EC's hierarchy of trade preferences. Only Romania and Yugoslavia benefited from the EC's generalized system of preferences (GSP), while exports from Central and Eastern Europe have generally faced significant trade obstacles, often in the form of quantitative restrictions (QRs), set at EC and/or national level.

Since 1989, however, the Community has been engaged in promoting the process of political and economic reforms in the countries of Central and Eastern Europe. Developments in the latter countries induced the Community to reconsider its relations in order to support the changes under way. To supplement the network of Agreements with the countries concerned, actions were taken to ensure that Trade and Cooperation Agreements were concluded with those countries not yet covered by such agreements, while at the same time redefining their objectives and content.

A number of import quotas were removed by the EC Member States already in 1990, as part of the Community's trade concessions. Originally, EC-wide quantitative restrictions were to be gradually phased out in the case of Hungary and Poland. Subsequently, the extension of Operation Phare to other countries resulted in the elimination or suspension of QRs *vis-à-vis* Central and Eastern Europe. QRs specifically aimed at these countries and operated nationally by Member States were eliminated, whereas non-specific QRs (covering glass, shoes, toys, leather, some machinery, some non-MFA products and some non-ECSC steel products) were suspended until the end of 1991. The generalized system of preferences was granted to all five Central and East European countries. The Trade and Cooperation Agreements envisaged specific provisions for certain sensitive sectors, which accounted for a substantial portion of exports from Central and Eastern Europe. For textiles, the CSFR, Hungary and Poland accepted an interim (not-renewable) arrangement aimed at replacing for a year the existing bilateral arrangements, with a view to putting the three countries on a par with other MFA participants.

Negotiations for the Association Agreements with the CSFR, Hungary and Poland started in December 1990 and were signed on 16 December 1991. The Agreements aim at the establishment of a free trade area and freedom of movement, as well as at economic and financial cooperation, with a view to ever-closer relations with the countries concerned. The free trade area is to be established at the end of a transitional period, of a maximum duration of ten years, divided into two successive stages of five years each, starting from the entry into force of the agreement (March 1992). Pending the ratification of the agreement by the national Parliaments, an interim agreement is currently in place to implement the provisions of the European Agreements on trade and trade-related matters.[1] Negotiations with a view to an association agreement with Bulgaria and Romania started in mid-May 1992. The trade component of these agreements is virtually the same as in the case of the CSFR, Hungary and Poland.

On the Community side, the Association Agreements consolidate all the previous unilateral trade concessions, while laying the ground for the complete removal of all trade obstacles by the end of the transitional period. The trade provisions involve the immediate removal of all quotas, while import tariffs will be progressively eliminated over a period ranging between 2 and 5 years. The Central European countries will reciprocate more slowly by phasing out tariffs and quotas over 4 to 9 years. As in the previous trade and cooperation agreements, the Association Agreements also contain specific provisions for certain sensitive sectors (textiles, agriculture, steel and coal).

3.3. Other agreements and arrangements

The European Community subscribes to the fundamental GATT principle of most-favoured nation treatment whereby GATT contracting parties should, in their trade policies, offer the same treatment to imports from all third countries without discrimination. Yet, by virtue of other GATT-accepted principles such as the 'enabling clause' which covers the generalized system of preferences (GSP) schemes and Article XXIV, the Community does grant preferential tariff treatment both to groupings of industrialized countries with whom it has free trade area agreements (namely EFTA) and to most developing countries as well.

The preferential treatment granted to LDC's reflects the Community's policy objective of giving support to the industrialization efforts in the poorer parts of the world. Yet, the preferential treatment towards LDCs is not uniform. On the contrary, depending on historical and geo-strategic factors the treatment is 'more preferential' in some cases than in others. More precisely, a hierarchy of regimes, a sort of 'pyramid of privileges', can be distinguished.

[1] Council Decision of 25 February 1992, OJ L 115/1, 30.4.1992.

(i) ACP countries

The Community relationship with this group of countries which includes a large number of least developed countries is the most extensive and privileged in the hierarchy. The Lomé Agreement between the Community and most of the countries of Africa, the Caribbean and the Pacific (a total of 69 since Lomé IV) grants to those countries tariff preferences that virtually allow for duty-free entry of industrial exports without any quantitative limitations. Imports of agricultural products are virtually duty free as well and, within some quantitative limits and calendar restrictions, they benefit from reductions and suspensions in their variable levies; furthermore, sugar and beef have a secured market access at favourable EC prices. Beyond the tariff and access benefits the Lomé Convention also provides extensive financial support (*inter alia*, to support ACP export earnings), and substantial technical assistance (through aid projects).

(ii) Mediterranean countries

Within a global framework common to all the countries of Southern Europe (Cyprus, Malta, Turkey and Yugoslavia) and the Southern (Algeria, Egypt, Morocco, Tunisia) and Eastern Mediterranean (Israel, Jordan, Lebanon, Syria) the Community has economic and commercial bilateral agreements of various kinds (cooperation, association, customs unions, etc.) with each of those countries providing for financial and technical aid and granting important trade preferences for their exports to the Community.

The extent of the trade preferences varies with the countries: they tend to be less than those granted to ACP countries for agricultural products but, for most industrial products, they allow for duty-free entry subject to tariff quotas in certain cases and to agreed bilateral arrangements, e.g. for textiles.

(iii) The GSP beneficiary countries

By virtue of its GSP scheme, the EC grants unilaterally, i.e. without any formal agreement and without involving reciprocity, a series of generalized[1] duty reductions for imports originating from LDCs. The granting of these reductions is made on a year-to-year basis but within a scheme whose structure has been established until now for 10-year periods.

To the extent that GSP concessions are, as a rule, granted to all developing countries, all LDCs are in a sense 'GSP countries'. However, because the preferential treatment within the GSP involves concessions that are less than those granted by the Lomé Convention and the Mediterranean agreements, the only countries that effectively make use of the GSP scheme are the non-Mediterranean Asian countries and the Latin American countries.

Outside the Lomé and Mediterranean agreements, the Community also has various trade and cooperation bilateral agreements of a non-preferential character with other LDCs. While these agreements do not involve specific import concessions, they normally include measures to facilitate and promote exports from those countries to the Community. Most of these agreements are with individual countries but some of them are with groups of countries instead. More precisely, the Community has commercial and cooperation agreements with the Asean, the Andean Group, the Central America Common Market and some Latin American (Mexico, Brazil, Uruguay, etc.) and Asian (Bangladesh, China, India, Pakistan, Sri Lanka, Yemen, etc.) countries.

[1] However, there are two significant exceptions to this principle: Korea and Taiwan. Korea, although formally a GSP beneficiary, has been explicitly, and on a temporary basis, suspended since 1988 from enjoying the preferences of the system. On the other hand, Taiwan, because it does not belong to the UN organizations, has never been granted GSP treatment.

II — Statistical information

Table 82

Community trade by major groups of countries[1]

Imports

(%)

Year	Industrialized countries					Developing countries							Eastern Europe[6]	STEs[7]	Total extra-EC (billion ECU)
	USA	Japan	EFTA	Other	Total	Latin America	ODs[2]	Mediter-ranean[3]	Asian NIEs[4]	ACP	OPEC[5]	Total			
1970	21,7	3,4	17,4	12,1	54,6	7,9	0,7	9,4	1,5	8,9	16,3	38,0	6,4	0,8	**61,8**
1975	17,6	4,2	15,6	8,3	45,7	5,7	0,7	7,5	2,4	7,4	27,9	45,7	6,9	0,9	**132,9**
1980	16,9	4,9	17,0	7,3	46,1	5,8	0,4	8,3	2,2	7,3	27,2	45,7	7,3	0,9	**282,5**
1981	17,2	5,4	16,8	7,1	46,4	6,4	0,5	8,9	3,3	6,0	27,0	45,4	7,3	0,9	**318,3**
1982	17,7	5,7	17,2	7,1	47,8	6,5	0,5	10,0	3,2	6,0	24,6	43,2	8,2	0,9	**335,4**
1983	17,2	6,4	19,2	7,1	49,8	7,2	0,4	10,3	3,7	6,5	21,0	40,6	8,6	1,0	**341,7**
1984	17,2	6,6	19,4	7,8	51,0	7,1	0,4	10,2	3,6	7,2	18,5	38,9	9,2	1,0	**390,6**
1985	17,0	7,0	20,2	8,0	52,1	7,3	0,4	10,9	3,5	7,5	17,8	38,4	8,4	1,1	**406,6**
1986	16,9	9,9	23,5	8,6	59,0	6,0	0,4	8,5	4,9	5,9	11,5	32,2	7,4	1,4	**334,6**
1987	16,5	10,2	24,3	8,2	59,2	5,7	0,5	8,6	6,0	4,9	10,3	31,9	7,2	1,7	**340,1**
1988	17,6	10,7	23,4	9,9	61,6	5,9	0,5	7,8	6,3	4,5	8,2	30,1	6,4	1,9	**387,9**
1989	18,7	10,4	23,0	8,6	60,6	5,8	0,5	8,3	6,0	4,4	9,1	30,7	6,5	2,2	**446,7**
1990	18,4	10,0	23,5	7,9	59,7	5,5	0,5	9,1	5,7	4,3	9,7	31,1	6,8	2,4	**462,7**

Exports

(%)

Year	Industrialized countries					Developing countries							Eastern Europe[6]	STEs[7]	Total extra-EC (billion ECU)
	USA	Japan	EFTA	Other	Total	Latin America	ODs[2]	Mediter-ranean[3]	Asian NIEs[4]	ACP	OPEC[5]	Total			
1970	18,0	2,6	25,1	13,6	59,3	6,7	1,7	10,3	2,1	7,6	7,5	31,0	7,3	1,5	**54,2**
1975	11,9	2,0	22,4	11,9	48,1	6,6	1,2	14,1	2,0	7,5	16,4	38,5	10,3	1,6	**118,5**
1980	12,8	1,0	25,5	10,3	49,6	6,1	1,1	13,4	2,7	7,9	18,1	41,2	8,0	1,2	**216,7**
1981	14,5	2,2	21,5	9,2	47,5	6,2	1,2	14,4	2,7	7,8	21,2	44,6	6,8	1,0	**265,3**
1982	15,7	2,3	22,1	8,9	48,9	5,2	1,2	12,9	3,0	7,2	20,7	43,8	6,3	1,0	**284,1**
1983	17,4	2,6	22,0	8,7	50,7	4,1	1,2	13,2	3,1	5,9	18,4	41,1	7,0	1,2	**300,6**
1984	21,0	2,7	21,8	9,5	55,0	4,1	1,2	12,3	3,3	5,2	15,6	37,4	6,3	1,3	**350,9**
1985	22,6	2,8	22,4	9,8	57,6	3,9	1,1	11,7	3,5	5,2	12,8	34,0	6,2	2,2	**378,7**
1986	22,0	3,3	25,5	9,6	60,5	4,0	1,3	11,2	3,7	4,8	10,3	31,5	5,9	2,2	**341,9**
1987	21,2	4,0	26,6	9,9	61,7	4,0	2,4	10,1	4,4	4,2	8,7	30,8	5,7	1,8	**339,3**
1988	19,8	4,7	26,6	10,1	61,2	3,6	2,4	9,8	5,4	4,3	8,6	31,3	5,7	1,8	**362,9**
1989	18,9	5,1	26,1	10,1	60,2	3,7	2,4	9,9	5,5	4,0	8,5	31,8	6,3	1,7	**413,0**
1990	18,2	5,4	26,5	9,6	59,8	3,6	2,4	10,9	5,5	4,0	8,4	32,0	6,7	1,5	**419,8**

[1] The country groupings are not mutually exclusive, thereby giving rise to some double counting as well as exclusions of trade flows. OPEC includes Nigeria and Gabon whose trade flows are also recorded under the ACP. Turkey, the former Yugoslavia and Malta appear under the industrialized countries as well as under the Mediterranean countries. The excluded countries concern in particular some South Asian countries (India, Pakistan, Sri Lanka, etc.), as well as some South-East Asian countries (Malaysia, Thailand, Philippines, etc.). These countries are, however, included in the developing countries total.

[2] Overseas departments and territories of the Member States of the European Community.

[3] Ceuta and Melilla, Gibraltar, Malta, Yugoslavia, Turkey, Albania, Morocco, Algeria, Tunisia, Libya, Egypt, Cyprus, Lebanon, Syria, Israel and Jordan.

[4] Newly industrializing economies of Hong Kong, South Korea, Singapore and Taiwan.

[5] Algeria, Libya, Nigeria, Gabon, Venezuela, Ecuador, Iraq, Saudi Arabia, Kuwait, Bahrain, Qatar, United Arab Emirates and Indonesia.

[6] Former USSR and GDR, CSFR, Hungary, Romania, Bulgaria, Albania and Poland.

[7] State-trading economies of America and Asia: Cuba, Vietnam, Mongolia, China and North Korea.

Table 83

Top 40 trading partners of the Community: Imports

Countries	Million ECU (current prices)		Share in total imports %	%	Cumulated growth %
	1980	1990	1980	1990	1980-90
United States of America	47 735	85 182	16,9	18,4	78,4
Japan	13 968	46 224	4,9	10,0	230,9
Switzerland	15 746	34 338	5,6	7,4	118,1
Austria	7 136	20 989	2,5	4,5	194,1
Sweden	11 918	19 296	4,2	4,2	61,9
Former Soviet Union	11 382	16 749	4,0	3,6	47,2
Norway	8 301	16 465	2,9	3,6	98,3
China	1 974	10 603	0,7	2,3	437,1
Finland	4 629	10 438	1,6	2,3	125,5
Canada	6 393	9 409	2,3	2,0	47,2
Brazil	4 778	9 203	1,7	2,0	92,6
Taiwan	2 241	9 159	0,8	2,0	308,7
Saudi Arabia	27 619	8 224	9,8	1,8	−70,2
Libya	7 488	7 888	2,7	1,7	5,3
Former Yugoslavia	2 184	7 684	0,8	1,7	251,8
South Africa	6 779	7 653	2,4	1,7	12,9
Algeria	4 435	6 940	1,6	1,5	56,5
South Korea	2 079	6 557	0,7	1,4	215,4
Turkey	1 053	5 943	0,4	1,3	464,4
Hong Kong	3 674	5 916	1,3	1,3	61,0
Iran	3 601	5 798	1,3	1,3	61,0
Poland	2 805	5 278	1,0	1,1	88,2
Australia	2 587	4 822	0,9	1,0	86,4
Singapore	1 886	4 694	0,7	1,0	148,9
India	1 841	4 553	0,7	1,0	147,3
Nigeria	8 185	4 386	2,9	0,9	−46,4
Thailand	1 263	4 105	0,4	0,9	225,0
Israel	1 660	3 467	0,6	0,7	108,9
Morocco	1 356	3 043	0,5	0,7	124,4
Hungary	1 430	3 004	0,5	0,6	110,1
Mexico	2 000	2 947	0,7	0,6	47,4
Indonesia	1 278	2 863	0,5	0,6	124,0
Czechoslovakia	1 544	2 786	0,5	0,6	80,4
Egypt	2 385	2 299	0,8	0,5	−3,6
Tunisia	1 380	2 250	0,5	0,5	63,0
Iraq	9 640	2 214	3,4	0,5	−77,0
Kuwait	4 228	1 851	1,5	0,4	−56,2
Venezuela	2 254	1 784	0,8	0,4	−20,9
United Arab Emirates	5 286	1 509	1,9	0,3	−71,5
Pakistan	467	1 461	0,2	0,3	212,8
Total of the above	248 588	409 974	88,0	88,6	64,9
Total extra-EC trade	282 532	462 720	100,0	100,0	63,8

Source: Eurostat.

Table 84

Shares of merchandise exports and imports by broad product group: EC, USA and Japan, 1980-90

(current prices)

		EC 12		USA		Japan	
		Exports (%)	Imports (%)	Exports (%)	Imports (%)	Exports (%)	Imports (%)
1980	Agriculture	2,6	9,3	15,5	4,6	0,3	14,1
	Energy	6,7	36,7	4,3	33,4	0,4	50,6
	Manufactures	90,7	54,0	80,2	62,0	99,3	35,3
1981	Agriculture	2,9	8,7	14,7	4,2	0,3	13,4
	Energy	7,6	38,6	4,9	31,3	0,3	51,1
	Manufactures	89,5	52,7	80,5	64,5	99,4	35,5
1982	Agriculture	2,6	8,8	13,8	4,4	0,3	13,3
	Energy	7,9	37,8	6,4	26,9	0,3	50,5
	Manufactures	89,5	53,4	79,7	68,7	99,5	36,2
1983	Agriculture	2,7	8,7	14,3	4,5	0,3	13,9
	Energy	7,2	33,9	5,2	22,7	0,3	47,6
	Manufactures	90,1	57,4	80,4	72,9	99,5	38,6
1984	Agriculture	2,8	8,8	14,0	4,1	0,3	14,1
	Energy	6,5	32,6	4,8	18,9	0,3	45,3
	Manufactures	90,7	58,6	81,3	77,0	99,5	40,6
1985	Agriculture	2,8	8,4	11,0	4,0	0,2	13,7
	Energy	6,3	31,3	5,3	15,9	0,3	44,0
	Manufactures	90,9	60,3	83,7	80,1	99,5	42,3
1986	Agriculture	2,6	8,6	9,1	4,2	0,3	15,4
	Energy	4,0	20,2	4,4	10,7	0,2	30,1
	Manufactures	93,5	71,2	86,6	85,1	99,5	54,6
1987	Agriculture	2,5	7,8	8,6	3,7	0,2	15,4
	Energy	3,8	17,7	3,4	11,5	0,3	27,1
	Manufactures	93,8	74,5	88,0	84,8	99,5	57,6
1988	Agriculture	2,5	7,3	9,1	3,4	0,3	14,6
	Energy	3,1	13,2	2,9	10,0	0,2	21,4
	Manufactures	94,4	79,5	88,1	86,6	99,5	64,0
1989	Agriculture	2,6	6,4	8,4	3,2	0,2	13,4
	Energy	3,1	15,0	3,2	11,7	0,3	21,3
	Manufactures	94,2	78,7	88,5	85,1	99,4	65,3
1990	Agriculture	2,4	5,9	7,6	3,0	0,2	11,6
	Energy	3,6	16,0	3,5	13,6	0,4	25,3
	Manufactures	94,0	78,2	88,9	83,3	99,4	63,2

The classification of goods is derived from the NACE-CLIO R44 nomenclature of products and branches: agriculture includes code 1; energy products are defined as the sum of codes 3+5+7+9+11, while manufactures comprise codes 13 to 51.

Source: Eurostat, Volimex.

Table 85

Community trade by product group[1]

	Share in total merchandise imports			Share in total merchandise exports	
	1980-81 %	1989-90 %		1980-81 %	1989-90 %
Mineral fuels and lubricants	35,5	15,3	Industrial machinery	16,0	15,3
Non-fuel crude materials	10,5	8,9	Chemicals and related products	10,8	12,3
Miscellaneous manufact. articles	5,4	8,8	Miscellaneous manufact. articles	8,1	10,8
Food products and tobacco	10,8	8,7	Other basic manufactures	10.5	9,9
Other basic manufactures	6,3	8,1	Road vehicles	10,1	9,6
Chemicals and related products	4,6	6,9	Food products and tobacco	9,1	8,2
Industrial machinery	3,7	5,9	Electrical machinery and apparatus	4,7	5,4
Office machinery	2,1	5,4	Iron and steel	6,0	4,0
Electrical machinery and apparatus	2,4	4,7	Power-generating machinery	3,7	3,6
Road vehicles	3,0	4,5	Other transport equipment	2,5	3,5
Clothing	3,0	4,5	Textiles	3,1	3,2
Telecoms and sound equipment	2,0	3,6	Clothing	1,6	2,7
Non-ferrous metals	3,2	3,3	Mineral fuels and lubricants	5,6	2,6
Other transport equipment	1,3	3,1	Office machinery	1,5	2,5
Power-generating machinery	1,4	2,6	Non-fuel crude materials	2,1	2,0
Textiles	2,4	2,6	Telecoms and sound equipment	1,9	1,8
Iron and steel	1,8	2,2	Non-ferrous metals	2,1	1,6
Footwear	0,5	0,8	Footwear	0,7	1,0
Total	100,0	100,0	Total	100,0	100,0
	Billion ECU, cif			Billion ECU, fob	
Total imports (SITC 0-8)	265,9	430,4	Total exports (SITC 0-8)	228,7	392,4

[1] Regroupings of SITC 2-digit product categories.
Source: Eurostat. Comext.

Table 86

Leading products in Community (EC-12) external trade, 1981-90

Imports					Exports				
SITC 2-digit product categories	1990 (million ECU)	Share in total imports (%)	Cumulated growth		SITC 2-digit product categories	1990 (million ECU)	Share in total exports (%)	Cumulated growth	
			1982-86 (%)	1986-90 (%)				1982-86 (%)	1986-90 (%)
Petroleum and derivatives	59 699	13,6	−48,5	21,3	Road vehicles	38 034	9,6	23,4	10,6
Office machines	23 277	5,3	93,9	56,5	Specialized industrial machinery	27 108	6,9	24,1	23,4
Clothing	20 551	4,7	36,1	71,3	General ind. machinery equip. and parts	25 987	6,6	17,7	24,7
Electrical machinery and apparatus	20 528	4,7	63,7	59,8	Electrical machinery and apparatus	21 635	5,5	26,4	34,1
Road vehicles	20 274	4,6	42,8	52,7	Miscellaneous manufact. products, n.e.s.	20 624	5,2	46,3	36,7
Miscellaneous manufact. products, n.e.s.	18 063	4,1	39,0	78,6	Power-generating machinery	15 089	3,8	9,0	33,2

Imports					Exports				
SITC 2-digit product categories	1990 (million ECU)	Share in total imports (%)	Cumulated growth		SITC 2-digit product categories	1990 (million ECU)	Share in total exports (%)	Cumulated growth	
			1982-86 (%)	1986-90 (%)				1982-86 (%)	1986-90 (%)
Telecoms and sound equipment	16 009	3,7	57,8	70,8	Non-metallic mineral manufactures	14 831	3,8	11,3	28,0
Other transport equipment	13 884	3,2	44,6	174,5	Iron and steel	14 247	3,6	−1,1	−5,0
Non-ferrous metals	13 410	3,1	9,9	61,0	Other transport equipment	14 086	3,6	−7,7	98,2
Paper, paperboard and related materials	13 033	3,0	49,9	55,8	Textile yarn and fabrics	12 823	3,2	35,8	19,2
General ind. machinery equip. and parts	12 329	2,8	33,2	61,0	Manufactures of metals	11 550	2,9	−0,9	15,2
Power-generating machinery	11 522	2,6	32,7	60,5	Clothing	10 774	2,7	81,5	30,8
Textile yarn and fabrics	11 425	2,6	26,6	34,7	Organic chemicals	10 256	2,6	30,3	38,3
Vegetables and fruit	10 248	2,3	−0,7	35,5	Petroleum and derivatives	10 081	2,6	−41,4	6,3
Specialized industrial machinery	10 024	2,3	51,7	63,4	Professional and scientific instruments	9 900	2,5	52,7	19,0
Iron and steel	9 090	2,1	16,4	36,8	Office machines	9 894	2,5	91,5	18,4
Professional and scientific instruments	8 923	2,0	53,9	44,1	Medical and pharmaceutical products	8 746	2,2	41,8	28,4
Metalliferous ores and metal scrap	8 750	2,0	12,9	17,7	Telecoms and sound equipment	7 174	1,8	23,2	15,0
Organic chemicals	8 365	1,9	48,1	46,4	Chemical materials and products, n.e.s.	6 991	1,8	34,0	28,9
Cork and wood	7 950	1,8	12,9	38,3	Beverages	6 517	1,6	23,5	29,8
Non-metallic mineral manufactures	7 910	1,8	32,6	27,2	Metal-working machinery	6 219	1,6	21,8	16,0
Manufactures of metals	7 210	1,6	26,9	54,5	Plastics in primary form	6 123	1,5	36,3	7 268,4
Photographic and optical goods	6 616	1,5	42,3	35,3	Non-ferrous metals	5 971	1,5	11,8	21,1
Fish, crustaceans, molluscs	6 396	1,5	67,6	58,7	Paper, paperboard and related materials	4 970	1,3	57,1	37,7
Pulp and waste paper	5 454	1,2	6,4	40,2	Cereals and cereal preparations	4 921	1,2	−4,5	25,3
Medical and pharmaceutical products	4 959	1,1	65,7	59,6	Furniture	4 911	1,2	52,9	18,9
Coke, coal and briquettes	4 914	1,1	5,5	6,3	Essential oils and perfume materials	4 820	1,2	40,7	43,7
Coffee, tea, cocoa, spices	4 877	1,1	55,1	−49,8	Photographic and optical products	4 562	1,2	27,4	19,0
Gas, natural and manufactured	4 710	1,1	−10,4	−4,3	Dyeing, tanning and colouring materials	4 363	1,1	38,6	34,5
Textile fibres and their waste	4 528	1,0	26,4	10,8	Footwear	4 214	1,1	73,4	19,4
Plastics in primary form	4 491	1,0	47,6	6 114,4	Dairy product and birds' eggs	3 546	0,9	−24,5	18,9
Feedingstuffs for animals	4 326	1,0	−0,6	−4,8	Rubber manufactures	3 321	0,8	30,9	10,9
Metal-working machinery	4 019	0,9	69,6	63,6	Inorganic chemicals	3 272	0,8	20,2	23,9
Footwear	3 425	0,8	15,3	102,5	Vegetables and fruit	3 138	0,8	57,3	17,7
Oilseeds and oleaginous fruits	3 336	0,8	−7,8	−6,2	Plastics in non-primary form	2 984	0,8	31,2	−61,5
Chemical materials and products, n.e.s.	3 278	0,7	54,9	44,4	Meat and meat preparations	2 924	0,7	47,4	12,5
Cork and wood products (excl. furniture)	3 240	0,7	11,3	60,0	Sugars, sugar preparations and honey	2 147	0,5	−25,4	52,2
Inorganic chemicals	2 815	0,6	15,0	−10,7	Machinery applicable to industrial plant	2 048	0,5	−6,4	9,7
Meat and meat preparations	2 738	0,6	−10,1	22,0	Leather products and dressed furskins	1 892	0,5	60,9	14,3
Furniture	2 657	0,6	31,7	61,1	Miscellaneous edible products	1 823	0,5	16,8	64,9
Total of the above	406 595	93,4	5,2	43,1	Total of the above	374 518	94,8	19,5	23,5
Total imports	437 939	100,0	5,6	40,1	Total exports	395 189	100,0	19,5	23,3

Source: Eurostat, Comext.

Table 87

Growth of Community trade volumes, 1980-91

(% average annual growth)

		1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1986-91	1980-91	1990 share
Imports															
Total goods[1]															
Extra-EC		−8,4	−2,5	−0,7	4,7	2,4	6,2	6,8	9,6	6,2	5,7	6,8	7,0	3,2	40,4
	Total														
Manufactures[2]		−4,6	−0,2	1,0	5,4	4,1	4,3	6,4	7,5	7,4	5,5	5,0	6,4	3,7	100,0
Extra-EC		−2,8	−0,9	3,0	9,0	2,8	8,2	9,1	13,3	8,3	7,9	7,1	9,1	5,8	36,2
	Total	−2,2	1,0	1,9	7,1	4,0	5,4	7,7	9,4	9,2	6,5	4,6	7,5	4,9	100,0
Exports															
Total goods[1]															
Extra-EC		7,7	−2,1	−1,2	7,5	4,3	−5,8	−2,1	0,7	5,0	−0,3	−0,1	0,6	1,1	38,3
	Total														
Manufactures[2]		2,7	−0,1	0,8	6,9	4,6	0,0	2,6	3,7	7,2	2,3	2,0	3,5	2,9	100,0
Extra-EC		6,7	−2,4	−1,8	8,1	4,5	−7,0	−2,8	0,6	5,5	−0,2	−0,5	0,5	0,9	40,2
	Total	2,2	−0,2	−0,3	7,4	4,5	−0,9	2,6	4,1	8,1	2,5	1,4	3,7	2,8	100,0

[1] SITC 0-8.
[2] SITC 5-8.
EC = EUR 10 until 1985.
Source: Eurostat.

Table 88

Top 40 trading partners of the Community: Exports

Countries	Million ECU (current prices)		Share in total exports %		Cumulated growth % 1980-90
	1980	1990	1980	1990	
United States of America	27 760	76 561	12,8	18,2	175,8
Switzerland	22 702	41 340	10,5	9,8	82,1
Austria	11 389	26 981	5,3	6,4	136,9
Sweden	11 980	23 941	5,5	5,7	99,8
Japan	4 810	22 721	2,2	5,4	372,4
Former Soviet Union	7 808	13 614	3,6	3,2	74,4
Norway	5 273	9 306	2,4	2,2	76,5
Canada	3 542	9 298	1,6	2,2	162,5
Finland	3 573	9 165	1,6	2,2	156,5
Former Yugoslavia	4 276	8 521	2,0	2,0	99,3
Saudi Arabia	7 833	7 756	3,6	1,8	−1,0
Turkey	1 917	7 722	0,9	1,8	302,8
Australia	3 150	6 817	1,5	1,6	116,4
Hong Kong	2 166	6 602	1,0	1,6	204,8
South Korea	967	6 061	0,4	1,4	526,8
India	2 371	6 019	1,1	1,4	153,9
South Africa	5 134	5 758	2,4	1,4	12,2
Singapore	1 756	5 689	0,8	1,4	224,0
China	1 784	5 318	0,8	1,3	198,1
Israel	1 719	5 240	0,8	1,2	204,8
Iran	3 524	5 021	1,6	1,2	42,5
Algeria	5 093	4 976	2,4	1,2	−2,3
Poland	2 892	4 934	1,3	1,2	70,6
Taiwan	886	4 917	0,4	1,2	455,0
Egypt	3 397	4 153	1,6	1,0	22,3
Mexico	2 491	3 881	1,1	0,9	55,8
Brazil	2 704	3 653	1,2	0,9	35,1
United Arab Emirates	2 125	3 567	1,0	0,8	67,9
Morocco	1 764	3 562	0,8	0,8	101,9
Thailand	1 619	3 429	0,7	0,8	111,8
Hungary	1 619	3 220	0,7	0,8	98,9
Tunisia	1 684	2 971	0,8	0,7	76,4
Czechoslovakia	1 405	2 909	0,6	0,7	107,0
Indonesia	1 288	2 841	0,6	0,7	120,6
Libya	4 530	2 660	2,1	0,6	−41,3
Nigeria	6 250	2 501	2,9	0,6	−60,0
Iraq	4 029	2 076	1,9	0,5	−48,5
Venezuela	1 833	1 692	0,8	0,4	−7,7
Pakistan	939	1 428	0,4	0,3	52,1
Total of the above	181 982	368 821	84,0	87,9	102,7
Total extra-EC trade	216 670	419 814	100,0	100,0	93,8

Source: Eurostat.

Table 89

Import penetration of the EC market (extra-EC imports as a percentage of apparent consumption[1])

NACE code		1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
22	Metals	21,3	19,5	20,4	22,1	21,6	21,8	21,4	21,5	25,5	23,8	23,3	24,8
24	Non-metallic minerals	3,5	3,8	3,7	3,9	4,4	4,6	4,7	4,8	5,1	5,4	5,5	6,1
25+26	Chemicals[2]	105,8	115,5	99,6	109,6	123,3	127,4	106,9	104,9	97,4	95,7	85,0	87,5
31	Manufacturing of metal articles	4,0	4,3	4,4	4,4	4,7	4,7	4,7	4,9	5,3	5,6	5,6	6,2
32	Mechanical engineering	12,6	14,3	14,3	13,9	14,8	16,5	16,1	16,8	17,2	17,8	18,1	19,0
33	Office mach. & data proc. equip.	30,3	33,4	30,7	32,0	36,8	35,5	33,7	36,2	36,4	38,2	36,8	37,8
34	Electrical engineering	13,6	15,9	15,9	16,4	18,4	18,7	17,6	18,0	19,2	20,2	19,9	20,9
35	Motor vehicles & parts	7,5	8,1	8,3	9,4	10,9	11,2	11,4	11,0	11,1	11,3	11,6	13,1
36	Other transport equipment	23,4	27,2	27,5	27,8	31,2	24,0	19,3	20,5	31,5	33,3	33,8	38,4
37	Instrument engineering	30,9	35,0	35,6	38,2	42,0	40,7	39,5	38,7	39,4	42,4	41,7	42,7
41/42	Food, drink & tobacco	6,7	7,0	6,9	6,9	7,3	7,0	6,1	5,9	6,2	6,1	5,8	5,7
43	Textiles	8,9	9,9	9,8	9,6	9,5	9,4	10,3	12,0	12,5	12,8	14,0	16,8
44	Leather goods	26,7	27,1	27,6	25,8	27,7	31,4	30,7	32,9	36,4	42,1	43,7	45,2
45	Footwear & clothing	21,3	24,0	24,0	22,7	24,8	25,3	26,6	28,8	29,7	32,7	34,1	37,8
46	Timber & wooden furniture	18,2	18,1	18,3	19,3	19,6	18,7	18,2	18,5	18,4	19,0	18,6	17,5
47	Paper, printing & publishing	12,2	13,4	13,1	12,9	14,2	13,5	13,0	13,3	13,6	14,2	13,2	12,5
48	Rubber & plastics	6,1	6,8	7,3	7,3	7,7	8,0	7,7	8,0	8,7	9,0	9,1	9,6
	Total	14,2	15,1	15,2	15,5	16,9	16,9	16,2	16,4	17,7	18,3	18,1	18,9

[1] Gross output plus total imports minus total exports. The Community is defined as EUR 9 during the entire period.
[2] Includes man-made fibres.

Source: VISA databank, Eurostat.

Table 90

High-tech products as a share of EC trade in manufactures with selected trade partners

Partner		1978	1980	1982	1984	1986	1987	1988	1989	1990
Imports										
Extra-EC	million ECU	19 309,7	30 345,4	40 284,2	56 678,1	61 572,4	65 446,1	78 705,3	92 875,0	95 794,2
	% of manufactures	27,1	30,9	29,4	31,7	30,6	29,7	30,8	30,9	31,4
USA	million ECU	8 320,5	11 884,7	16 575,3	23 106,9	22 814,9	22 039,5	26 152,5	33 332,2	33 532,3
	% of manufactures	44,9	43,3	47,4	52,0	54,2	52,5	51,6	52,5	52,1
Japan	million ECU	3 171,2	4 660,5	6 959,8	10 771,1	14 127,9	15 255,4	18 440,9	20 657,1	20 124,7
	% of manufactures	34,7	36,3	38,2	41,7	41,7	42,6	44,2	44,1	42,9
EFTA	million ECU	3 880,6	4 636,7	5 897,0	8 114,3	10 418,2	11 430,7	12 339,5	13 851,8	14 812,4
	% of manufactures	17,1	16,3	16,1	17,4	18,7	19,2	18,5	18,4	18,6
Exports										
Extra-EC	million ECU	26 590,0	35 413,9	45 451,7	59 009,9	62 149,8	59 230,2	62 952,2	71 221,7	72 509,9
	% of manufactures	20,5	22,5	20,0	20,6	21,1	20,1	20,3	20,3	20,7
USA	million ECU	3 431,6	4 450,8	6 801,6	11 486,7	13 494,6	12 884,2	14 113,9	16 122,9	16 449,0
	% of manufactures	19,1	21,9	21,2	19,9	21,5	21,4	23,2	24,3	25,6
Japan	million ECU	590,3	798,5	1 080,3	1 224,8	1 623,6	1 719,0	2 140,7	2 261,5	2 362,9
	% of manufactures	19,4	21,5	20,4	16,9	17,8	15,4	15,2	12,8	12,2
EFTA	million ECU	4 773,9	6 284,0	7 057,5	9 701,3	12 545,7	12 979,4	13 996,5	15 471,8	15 596,1
	% of manufactures	16,5	16,3	15,0	16,3	17,3	17,0	17,0	16,8	16,6

Source: Eurostat.

Table 91

Annual average growth rates of Community exports and imports of high-tech products by selected trade partners, 1982-90, in value terms

(%)

	Extra-EC	USA	Japan	EFTA	MC15[1]
Exports					
1982-86	8,1	18,7	10,7	15,5	6,5
1986-90	3,9	5,1	9,8	5,6	7,2
1982-90	6,0	11,7	10,3	10,4	6,8
Imports					
1982-86	11,2	8,3	19,4	15,3	20,3
1986-90	11,7	10,1	9,2	9,2	21,0
1982-90	11,4	9,2	14,2	12,2	20,6

[1] MC15 = most competitive developing countries. The group includes Argentina, Brazil, Hong Kong, India, Indonesia, Israel, Macau, Malaysia, Mexico, Philippines, Singapore, South Korea, Taiwan, Thailand and the former Yugoslavia.

Source: Eurostat and Comtrade database.

Table 92

Community trade in high-tech products: export/import ratio by selected trade partners, 1982-90

Partner	1982	1984	1986	1987	1988	1989	1990	1991
Extra-EC	1,1	1,0	1,0	0,9	0,8	0,8	0,8	0,8
USA	0,4	0,5	0,6	0,6	0,5	0,5	0,5	0,5
Japan	0,2	0,1	0,1	0,1	0,1	0,1	0,1	0,1
EFTA	1,2	1,2	1,2	1,1	1,1	1,1	1,1	0,9
MC15[1]	2,0	1,2	1,2	0,9	0,7	0,8	0,8	0,7

[1] See Table 91 for definition.

Source: Eurostat and Comtrade database.

Table 93

Breakdown of trade in high-tech products by reporter and partner, 1978-90

(%)

Partner/reporter	1978					1986					Average 1989-90				
	EUR 12	USA	Japan	EFTA	MC15[1]	EUR 12	USA	Japan	EFTA	MC15[1]	EUR 12	USA	Japan	EFTA	MC15[1]
Exports															
EUR 12	*	12,9	2,2	18,0	14,3	*	21,7	2,6	20,2	14,3	*	22,7	3,2	21,6	16,0
USA	33,6	*	6,7	4,9	21,2	34,1	*	10,3	4,1	21,6	34,3	*	11,0	3,9	25,3
Japan	18,8	29,0	*	2,6	25,2	20,3	40,4	*	2,8	20,7	23,5	36,2	*	2,4	27,1
EFTA	39,7	8,2	2,5	*	10,3	45,1	10,8	2,2	*	10,1	52,1	8,9	2,9	*	10,0
Imports															
EUR 12	*	43,1	16,4	20,1	8,2	*	37,1	22,9	16,9	11,7	*	35,4	21,6	15,2	15,9
USA	20,6	*	32,9	4,2	28,0	18,5	*	39,3	2,8	29,0	17,5	*	33,7	2,3	34,2
Japan	20,6	57,4	*	6,5	14,0	15,2	64,0	*	4,8	14,4	13,2	57,1	*	5,2	21,3
EFTA	55,5	17,4	7,9	*	1,9	53,3	17,1	12,1	*	3,7	52,4	18,2	11,4	*	6,4

Percentages add up horizontally. Thus, for example, in 1989-90 the USA, Japan, EFTA and MC15 accounted for 63,5% of total EC exports.
[1] See Table 91 for definition.
Source: Eurostat.

List of contents of European Economy Nos 1 to 51

1, November 1978	— *Annual Economic Report 1978-79* — *Annual Economic Review 1978-79*
2, March 1979	— *European Monetary System* Texts of the European Council of 4 and 5 December 1978
3, July 1979	— *Short-term economic trends and prospects* — *The European Monetary System* Commentary Documents
4, November 1979	— *Annual Economic Report 1979-80* — *Annual Economic Review 1979-80*
Special issue 1979	— *Changes in industrial structure in the European economies since the oil crisis 1973-78* — *Europe — its capacity to change in question!*
5, March 1980	— *Short-term economic trends and prospects* — *Adaptation of working time*
6, July 1980	— *Short-term economic trends and prospects* — *Borrowing and lending instruments looked at in the context of the Community's financial instruments*
7, November 1980	— *Annual Economic Report 1980-81* — *Annual Economic Review 1980-81*
8, March 1981	— *Economic trends and prospects* — *The Community's borrowing and lending operations — recent developments*
9, July 1981	— *Fifth medium-term economic policy programme* — *The main medium-term issues: an analysis*
10, November 1981	— *Annual Economic Report 1981-82* — *Annual Economic Review 1981-82*
11, March 1982	— *Economic trends and prospects* — *Unit labour costs in manufacturing industry and in the whole economy*
12, July 1982	— *Documents relating to the European Monetary System*
13, September 1982	— *The borrowing and lending activities of the Community in 1981*
14, November 1982	— *Annual Economic Report 1982-83* — *Annual Economic Review 1982-83*
15, March 1983	— *Economic trends and prospects* — *Budgetary systems and procedures* — *Industrial labour costs* — *Greek capital markets*
16, July 1983	— *Business investment and the tax and financial environment* — *Energy and the economy: a study of the main relationships in the countries of the European Community*

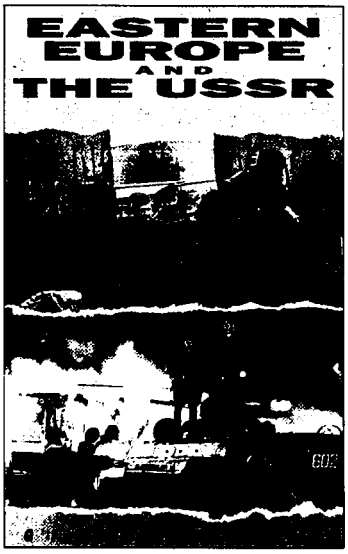
	— *The foreign trade of the Community, the United States and Japan*
17, September 1983	— *The borrowing and lending activities of the Community in 1982*
18, November 1983	— *Annual Economic Report 1983-84* — *Annual Economic Review 1983-84*
19, March 1984	— *Economic trends and prospects* — *Industrial labour costs* — *Medium-term budget balance and the public debt* — *The issue of protectionism*
20, July 1984	— *Some aspects of industrial productive performance in the European Community: an appraisal* — *Profitability, relative factor prices and capital/labour substitution in the Community, the United States and Japan, 1960-83* — *Convergence and coordination of macroeconomic policies: some basic issues*
21, September 1984	— *Commission report to the Council and to Parliament on the borrowing and lending activities of the Community in 1983*
22, November 1984	— *Annual Economic Report 1984-85* — *Annual Economic Review 1984-85*
23, March 1985	— *Economic trends and prospects 1984-85*
24, July 1985	— *The borrowing and lending activities of the Community in 1984*
25, September 1985	— *Competitiveness of European industry: situation to date* — *The determinants of supply in industry in the Community* — *The development of market services in the European Community, the United States and Japan* — *Technical progress, structural change and employment*
26, November 1985	— *Annual Economic Report 1985-86* — *Annual Economic Review 1985-86*
27, March 1986	— *Employment problems: views of businessmen and the workforce* — *Compact — A prototype macroeconomic model of the European Community in the world economy*
28, May 1986	— *Commission report to the Council and to Parliament on the borrowing and lending activities of the Community in 1985*
29, July 1986	— *Annual Economic Review 1986-87*
30, November 1986	— *Annual Economic Report 1986-87*
31, March 1987	— *The determinants of investment* — *Estimation and simulation of international trade linkages in the Quest model*
32, May 1987	— *Commission report to the Council and to Parliament on the borrowing and lending activities of the Community in 1986*

33, July 1987	— *The economic outlook for 1988 and budgetary policy in the Member States*
	— *Economic trends in the Community and Member States*
34, November 1987	— *Annual Economic Report 1987-88*
35, March 1988	— *The economics of 1992*
36, May 1988	— *Creation of a European financial area*
37, July 1988	— *Commission report to the Council and to Parliament on the borrowing and lending activities of the Community in 1987*
38, November 1988	— *Annual Economic Report 1988-89*
39, March 1989	— *International trade of the European Community*
40, May 1989	— *Horizontal mergers and competition policy in the European Community*
41, July 1989	— *The borrowing and lending activities of the Community in 1988*
	— *Economic convergence in the Community: a greater effort is needed*
42, November 1989	— *Annual Economic Report 1989-90*
43, March 1990	— *Economic transformation in Hungary and Poland*
44, October 1990	— *One market, one money*
Special edition 1990	— *The impact of the internal market by industrial sector: the challenge for the Member States*
45, December 1990	— *Stabilization, liberalization and devolution*
46, December 1990	— *Annual Economic Report 1990-91*
47, March 1991	— *Developments on the labour market in the Community*
	— *Quest — A macroeconomic model for the countries of the European Community as part of the world economy*
Special edition No 1/91	— *The economics of EMU*
Special edition No 2/91	— *The path of reform in Central and Eastern Europe*
48, September 1991	— *Fair competition in the internal market: Community State aid policy*
	— *The ecu and its role in the process towards monetary union*
49, 1993	(In preparation)
50, December 1991	— *Annual Economic Report 1991-92*
Special edition No 1/92	— *The economics of limiting CO_2 emissions*
51, May 1992	— *The climate challenge: Economic aspects of the Community's strategy for limiting CO_2 emissions*

Eastern Europe and the USSR

THE CHALLENGE OF FREEDOM

GILES MERRITT



The sparks of unrest that leapt from Berlin in November 1989 to Moscow's Red Square in August 1991 are firing an explosion of political and economic change. Out of the ashes of Communism is emerging the shape of a vast new European market-place stretching from the Atlantic to the Pacific.

In his fascinating account of Europe's fast-changing East-West relationships, Giles Merritt argues that a massive rescue operation must be mounted to ensure the success of these changes. The upheaval of Communism's collapse is 'The challenge of freedom'.

Written with the cooperation and support of the European Commission, this book sets out to identify the key policy areas where a new partnership is being forged between the countries of Eastern and Western Europe. It offers a privileged insight into the current thinking of European Community officials, politicians and industrial leaders, and analyses the factors that will determine whether the emerging market economies of Eastern Europe can truly be absorbed into a single European economy.

Immensely readable and often disturbing, this important book contains much up-to-date and hitherto unpublished information on such major East-West problem areas as energy, environmental control, immigration, trade relations, agriculture and investment. It also examines the arguments surrounding a 'Marshall Plan' for Eastern Europe that would emulate the famous US aid programme that helped relaunch the economies of Western Europe in the aftermath of World War II.

For anyone concerned about the future of Eastern Europe and the USSR, whether from a political, social or economic standpoint, this book is essential reading.

---

256 pp. — Price: ECU 14.30 *(excluding VAT)*
CM-71-91-655-EN-C

15/02/93

Bulletin of the European Communities

The *Bulletin of the European Communities*, which is issued 10 times a year (monthly, except for the January/February and July/August double issues), is an official reference publication covering all spheres of Community activity.

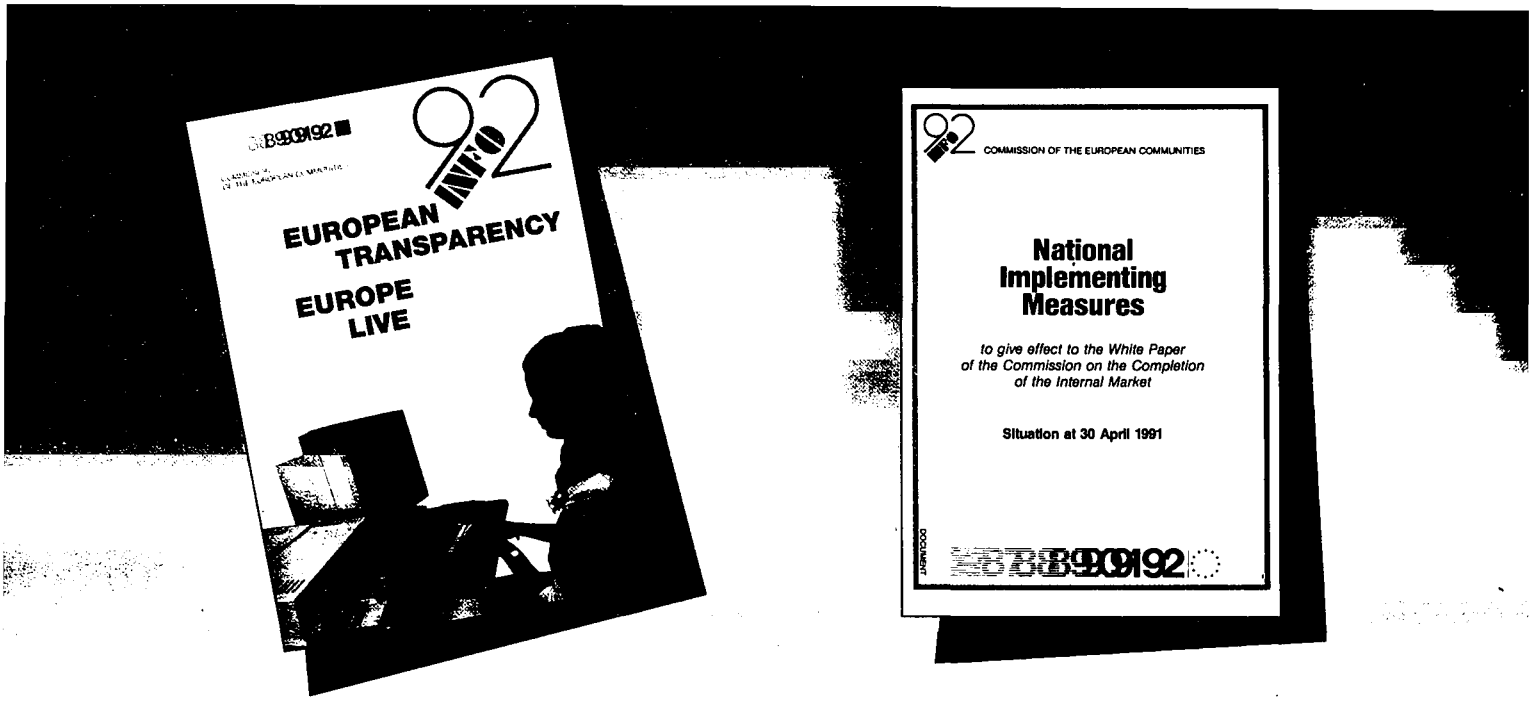
It is compact, easy to consult (with an index and copious references to the Official Journal and to previous issues), logically structured (to reflect the main fields of Community policy) and wholly reliable. The Bulletin is an essential reference tool, describing the passage of Community legislation through all its stages from presentation of a proposal by the Commission to final enactment by the Council.

Thanks to its topical commentaries on the month's major events, it provides the student of European integration and other interested readers with up-to-date and accurate information about the most recent developments in Community policy — the creation of a single market, economic and social integration, the Community's role in international affairs, etc.

Supplements to the Bulletin are published from time to time, containing important background material on significant issues of the day. Recent Supplements have covered German unification, the Commission's programme for 1992 and European industrial policy for the 1990s.

The Bulletin and its Supplements are produced by the Secretariat-General of the Commission, 200 rue de la Loi, B-1049 Brussels, in the nine official languages of the Community, and can be ordered from the Community sales agents.

15/02/93



INFO92

The Community database focusing on the objectives and the social dimension of the single market

As a practical guide to the single market, INFO92 contains vital information for all those determined to be ready for 1992.

INFO92 is really a simple market scoreboard, recording the state of play on the stage-by-stage progress of Commission proposals up to their adoption by the Council, summarizing each notable development and placing it in context, and keeping track of the transposition of directives into Member States' national legislation.

Using INFO92 is simplicity itself. It can be consulted on-screen by means of a wide range of everyday equipment connected to specialized data-relay networks. Fast transmission, the virtually instant updating facility (several times a day, if necessary) and dialogue procedures requiring no prior training make INFO92 ideal for the general public as well as for business circles and the professions.

The system offers easy access to information thanks to the choice of menus available and to the logical presentation modelled on the structure of the *White Paper*, the *Social Charter* and the decision-making process within the institutions.

Enquiries may also be made to the Commission Offices in the Member States or – for small businesses – the Euro-Info Centres now open in all regions of the Community.

Eurobases Helpdesk { Tel. : (32-2) 295 00 03
Fax : (32-2) 296 06 24

15/02/93

Official Journal of the European Communities

DIRECTORY

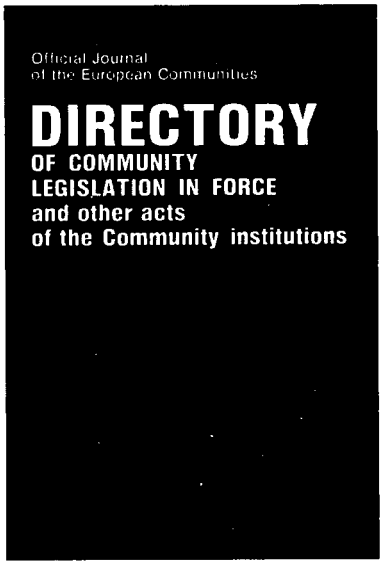
OF COMMUNITY LEGISLATION IN FORCE and other acts of the Community institutions

The Community's legal system is of direct concern to the individual citizen as much as to the Member States themselves.

Both lawyers and non-lawyers, then, need to be familiar not just with national law, but also with Community legislation, which is implemented, applied or interpreted by national law and in some cases takes precedence over it.

To make Community legislation more accessible to the public, the Commission of the European Communities publishes a Directory, updated twice a year, covering:

- binding instruments of secondary legislation arising out of the Treaties establishing the three Communities (regulations, decisions, directives, etc.);
- other legislation (internal agreements, etc.);
- agreements between the Communities and non-member countries.



Each entry in the Directory gives the number and title of the instrument, together with a reference to the Official Journal in which it is to be found. Any amending instruments are also indicated, with the appropriate references in each case.

The legislation is classified by subject matter. Instruments classifiable in more than one subject area appear under each of the headings concerned.

1 064 pp. – ECU 83
ISBN 92-77-77093-7 (Volume I)
ISBN 92-77-77094-5 (Volume II)
ISBN 92-77-77095-3 (Volume I and II)
FX-86-91-001-EN-C
FX-86-91-002-EN-C

The Directory proper (Vol. I) is accompanied by two indexes (Vol. II), one chronological by document number and the other alphabetical by keyword.

The Directory is available in the nine official languages of the Community.

15/02/93

EUROPEAN ECONOMY

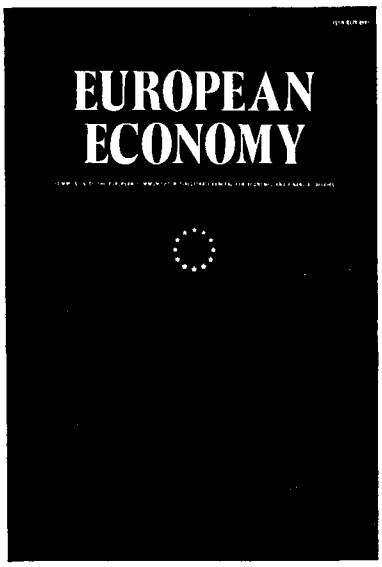
European Economy appears four times a year, in March, May, July and November. It contains important reports and communications from the Commission to the Council and to Parliament on the economic situation and developments, as well as on the borrowing and lending activities of the Community. In addition, *European Economy* presents reports and studies on problems concerning economic policy.

Two supplements accompany the main periodical:

- Series A – 'Economic trends' appears monthly except in August and describes with the aid of tables and graphs the most recent trends of industrial production, consumer prices, unemployment, the balance of trade, exchange rates, and other indicators. This supplement also presents the Commission staff's macroeconomic forecasts and Commission communications to the Council on economic policy.
- Series B – 'Business and consumer survey results' gives the main results of opinion surveys of industrial chief executives (orders, stocks, production outlook, etc.) and of consumers (economic and financial situation and outlook, etc.) in the Community, and other business cycle indicators. It also appears monthly, with the exception of August.

Unless otherwise indicated, the texts are published under the responsibility of the Directorate-General for Economic and Financial Affairs of the Commission of the European Communities, 200 rue de la Loi, B-1049 Brussels, to which enquiries other than those related to sales and subscriptions should be addressed.

Subscription terms are shown on the back cover and the addresses of the sales offices are shown on the third page of the cover.



15/02/93

Success in business

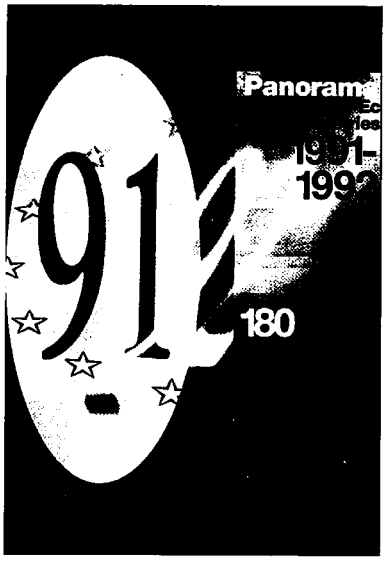
depends on the decisions you make ... which depend on the information you receive

Make sure that your decisions are based on information that is accurate and complete!

In a period of rapid adjustment, with national economies merging into a single European economy under the impetus of 1992, reliable information on the performance of specialized industry sectors is essential to suppliers, customers, bankers and policymakers.

Small and medium-sized enterprises, in particular, need easy access to information.

The market must be defined, measured and recorded. Information is needed on production capacities, bottlenecks, future developments, etc.



Panorama of EC industry 1991-1992
Current situation and outlook for 180 sectors of manufacturing and service industries in the European Community

1 400 pp.* ECU 110 * ISBN 92-826-3103-6 * CO-60-90-321-EN-C

15/02/93

SOCIAL EUROPE

Social Europe, published by the Commission of the European Communities, Directorate-General for Employment, Industrial Relations and Social Affairs (DG V), Coordination and Information Policy Unit, deals with current social affairs in Europe.

The basic review appears three times a year. In addition, a number of supplements/files are published annually, each dealing in depth with a given subject.

OFFICE FOR OFFICIAL PUBLICATIONS OF THE EUROPEAN COMMUNITIES
2, rue Mercier — L-2985 Luxembourg [Tel. (352) 499 28-1]

ENERGY

A CHALLENGE FOR EUROPE AND THE WORLD

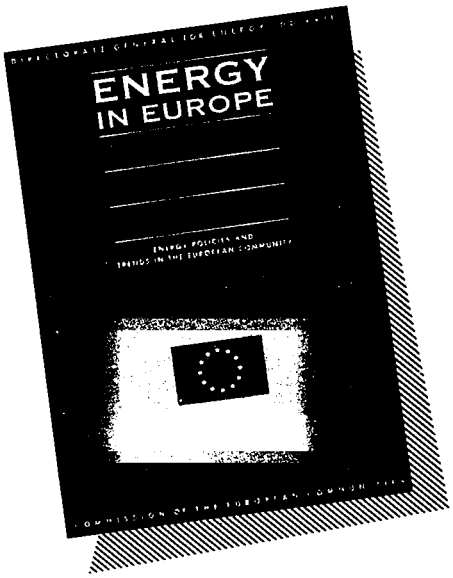
Since it first appeared in 1985 **Energy in Europe** has become recognized as an invaluable source of information on both the policy-making and the operational aspects of European Community energy policy. Subscribers include leaders of energy-consuming and energy-producing industries and other decision-makers in the private and public sectors, as well as major consultancies and research institutes in and outside the Community.

In the present situation within the Community, itself at the eve of the single market, and *vis-à-vis* the huge energy problems, as well as the potential, of our neighbours in Central and Eastern Europe and in the Commonwealth of Independent States, the energy sector is of the greatest strategic importance. An understanding of it is indispensable in many areas of economic activity. It also constitutes a crucial factor within a debate of truly global importance, namely the protection of the environment, including the global warming issue.

Energy in Europe continues to keep its readers abreast of the ongoing situation as regards overall policy, markets, energy planning, and the constant quest for cleaner and more efficient energy technology.

Market trends and perspectives are covered in **two regular issues** each year, and also in a **Short-term energy outlook** appearing in the first half of the year and an **Annual energy review** at the end of the year which includes the world energy situation by region including EC Member States, the short-term energy outlook for the Community, and a review of trends in main indicators over 10 years. Further **Special Issues** are also produced in connection with major developments or events, including international conferences on or relevant to the energy sector.

Energy in Europe appears in English but each issue also contains translations into French, German or Spanish of articles from the preceding issue.



15/02/93

Also available:

Treaty on European Union

253 pp. * ECU 9 * ISBN 92-824-0959-7 * RX-73-92-796-EN-C — 1992

Conradh ar an Aontas Eorpach

253 pp. * ECU 9 * ISBN 92-824-0964-3 * RX-73-92-796-GA-C — 1992

National implementing measures to give effect to the White Paper of the Commission on the completion of the internal market *Situation at 31 October 1992*

448 pp. * ECU 47 * ISBN 92-826-4973-3 * CM-76-92-875-EN-C — 1992

Reports of Commission Decisions relating to competition – 1989/1990

247 pp. * ECU 12 * ISBN 92-826-3868-5 * CV-73-92-772-EN-C — 1992

Harmonization of company law in the European Community – Measures adopted and proposed – *Situation as at 1 March 1992*

518 pp. * ECU 54 * ISBN 92-826-4314-X * C1-74-92-831-EN-C — 1992

Green Paper on the development of the single market for postal services (Communication from the Commission) – COM(91) 476 final

371 pp. * ISBN 92-77-45007-X * CB-CO-92-263-EN-C — 1992

Farm take-over and farm entrance within the EEC

148 pp. * ECU 15 * ISBN 92-826-3667-4 * CM-73-91-376-EN-C — 1992

Copyright and information limits to the protection of literary and pseudo-literary works in the Member States of the EC

262 pp. * ECU 27 * ISBN 92-826-3666-6 * CM-75-92-049-EN-C — 1992

Social security for persons moving within the Community – *Social Europe 3/92*

154 pp. * ECU 19 * ISSN 0255-0776 * CE-AA-92-003-EN-C — 1992

Urban social development – *Social Europe – Supplement 1/92*

125 pp. * ECU 9 * ISBN 92-826-4013-2 * CE-NC-92-001-EN-C — 1992

Enterprise and people aspects in the information technology sector to the year 2000 – *Social Europe – Supplement 2/92*

111 pp. * ECU 9 * ISBN 92-826-4537-1 * CE-NC-92-002-EN-C — 1992

15/02/93

Towards a Europe of solidarity: housing – *Social Europe – Supplement 3/92*

142 pp. * ECU 9 * ISBN 92-826-4567-3 * CE-NC-92-003-EN-C — 1992

The regulation of working conditions in the Member States of the European Community – Volume 1 – *Social Europe – Supplement 4/92*

114 pp. * ECU 9 * ISBN 92-826-4996-2 * CE-NC-92-004-EN-C — 1992

EUR 14197 – Evaluation of economic effects: relevance and impacts of EC programmes promoting industrial R&D with special emphasis on small and medium-sized enterprises (pilot methodological study)
K. HORNSCHILD, F. MEYER-KRAHMER

129 pp. * ECU 13.50 * ISBN 92-826-3817-0 * CD-NA-14197-EN-C — 1992

EUR 14198 – Evaluation of the impact of European Community research programmes upon the competitiveness of European industry – concepts and approaches
J.S. METCALFE, L. GEORGHIOU, P. CUNNINGHAM, H.M. CAMERON

44 pp. * ECU 6.00 * ISBN 92-826-3818-9 * CD-NA-14198-EN-C — 1992

Employment in Europe – 1992

206 pp. * ECU 11.25 * ISBN 92-826-4559-2 * CE-75-92-106-EN-C — 1992

Focus on the East – *Energy in Europe*

157 pp. * ECU 19 * ISSN 1017-6705 * CS-BI-92-001-4H-C — 1992

A view to the future – *Energy in Europe*

176 pp. * ECU 19 * ISBN 92-826-3665-8 * CS-75-92-841-EN-C — 1992

The finances of Europe, Daniel STRASSER

439 pp. * ECU 18.50 * ISBN 92-826-2306-8 * CM-60-90-280-EN-C — 1992

XXIst Report on Competition Policy – 1991

446 pp. * ECU 29 * ISBN 92-826-3850-2 * CM-73-92-247-EN-C — 1992

Europe in figures – *Third edition*

256 pp. * ECU 16.50 * ISBN 92-826-3371-1 * CA-70-91-895-EN-C — 1992

Inventory of taxes levied in the Member States of the European Communities – *14th edition*

726 pp. * ECU 80 * ISBN 92-826-0417-9 * CM-59-90-855-EN-C — 1992

A common market for services – *Banking • Insurance • Transactions in securities • Transport services • New technologies and services • Capital movements • Free movement of labour and the professions*
(Completing the internal market – Volume 1)

169 pp. * ECU 17 * ISBN 92-826-3566-X * CO-62-91-001-EN-C — 1992

The elimination of frontier controls – *Control of goods • Control of individuals • Value-added tax • Excise duties*
(Completing the internal market – Volume 2)

88 pp. * ECU 17 * ISBN 92-826-3573-2 * CO-62-91-002-EN-C — 1992

Conditions for business cooperation – *Company law • Intellectual property • Company taxation* – **Public procurement**
(Completing the internal market – Volume 3)

86 pp. * ECU 17 * ISBN 92-826-3583-X * CO-62-91-003-EN-C — 1992

Community social policy – *Labour market • Employment and pay • Improved living and working conditions • Free movement of workers • Social protection • Freedom of association and collective bargaining • Information, consultation and participation of employees • Equal treatment for men and women • Vocational training • Health and safety at work • Rights and protection of children and adolescents • The elderly • The disabled*
(Completing the internal market – Volume 6)

308 pp. * ECU 34 * ISBN 92-826-3609-7 * CO-62-91-006-EN-C — 1992

The current situation, evolution and future prospects for agriculture in Yugoslavia

128 pp. * ECU 12 * ISBN 92-826-3485-X * CM-72-91-899-EN-C — 1992

A practical guide to cross-border cooperation

112 pp. * ECU 10 * ISBN 92-826-3143-5 * CT-70-91-992-EN-C — 1992

1992: a pivotal year (address by Jacques Delors, President of the Commission, to the European Parliament) – **From the Single Act to Maastricht and beyond: the means to match our ambitions – The Commission's programme for 1992** – *Supplement 1/92 – Bull. EC*

45 pp. * ECU 5 * ISBN 92-826-3841-3 * CM-NF-92-001-EN-C — 1992

Research after Maastricht: an assessment, a strategy – *Supplement 2/92 – Bull. EC*

49 pp. * ECU 5 * ISBN 92-826-4307-7 * CM-NF-92-002-EN-C — 1992

15/02/93

Europe and the challenge of enlargement – *Supplement 3/92 – Bull. EC*

24 pp. * ECU 5 * ISBN 92-826-4524-X * CM-NF-92-003-EN-C — 1992

The creation of the internal market in insurance, Bill POOL

126 pp. * ECU 10.50 * ISBN 92-826-0246-X * CB-58-90-336-EN-C — 1992

European Economy – No 44 – One market, one money – An evaluation of the potential benefits and costs of forming an economic and monetary union

351 pp. * ECU 18 * ISSN 0379-0991 * CB-AR-90-044-EN-C — 1992

European Economy – The economics of EMU – Background studies for European Economy No 44 'One market, one money' *Special edition No 1 – 1991*

248 pp. * ECU 18 * ISBN 92-826-1996-6 * CM-60-90-208-EN-C — 1992

European Economy – No 51 – The climate challenge – Economic aspects of the Community's strategy for limiting CO_2 emissions

253 pp. * ECU 23.50 * ISSN 0379-0991 * CM-AR-92-051-EN-C — 1992

Practical guide to legal aspects of industrial subcontracting within the European Community – Volume I – The subcontract

118 pp. * ECU 11.25 * ISBN 92-825-9593-5 * CB-27-89-001-EN-C — 1992

Practical guide to legal aspects of industrial subcontracting in the European Community – Volume II – The legal framework of subcontracting in the twelve Member States

70 pp. * ECU 9 * ISBN 92-826-4651-3 * CB-27-89-002-EN-C — 1992

The rules governing medicinal products in the European Community – Volume I – The rules governing medicinal products for human use in the European Community – *Revised edition / September 1991*

228 pp. * ECU 20 * ISBN 92-826-3166-4 * CO-71-91-631-EN-C — 1992

The rules governing medicinal products in the European Community – Volume II – Notice to applicants for marketing authorizations for medicinal products for human use in the Member States of the European Community

186 pp. * ECU 16.50 * ISBN 92-825-9503-X * CB-55-89-293-EN-C — 1992

The rules governing medicinal products in the European Community – Volume III – *Addendum No 2 – May 1992* – **Guidelines on the quality, safety and efficacy of medicinal products for human use**

206 pp. * ECU 23 * ISBN 92-826-4550-9 * CO-75-92-558-EN-C — 1992

The rules governing medicinal products in the European Community – Volume IV – **Good manufacturing practice for medicinal products**

177 pp. * ECU 19.50 * ISBN 92-826-3180-X * CO-71-91-760-EN-C — 1992

The rules governing medicinal products in the European Community – Volume V – **Veterinary medicinal products**

158 pp. * ECU 14.25 * ISBN 92-825-9643-5 * CB-55-89-972-EN-C — 1992

The rules governing medicinal products in the European Community – Volume VI – **Establishment by the European Community of maximum residue limits (MRLs) for residues of veterinary medicinal products in foodstuffs of animal origin**

127 pp. * ECU 13.50 * ISBN 92-826-3173-7 * CO-71-91-768-EN-C — 1992

Credit Institutions – Community measures adopted or proposed – *Situation as at August 1992*

356 pp. * ECU 37 * ISBN 92-826-4842-7 * C1-76-92-293-EN-C — 1992

New information technology in education – France

110 pp. * ECU 13 * ISBN 92-826-4771-4 * CY-03-92-007-EN-C — 1992

New information technology in education – Germany

124 pp. * ECU 13 * ISBN 92-826-4683-1 * CY-03-92-004-EN-C — 1992

New information technology in education – Denmark

138 pp. * ECU 14 * ISBN 92-826-4681-5 * CY-03-92-003-EN-C — 1992

New information technology in education – The Netherlands

108 pp. * ECU 12 * ISBN 92-826-4779-X * CY-03-92-011-EN-C — 1992

New information technology in education – Luxembourg

122 pp. * ECU 13 * ISBN 92-826-4777-3 * CY-03-92-010-EN-C — 1992

Removal of tax obstacles to the cross-frontier activities of companies – *Supplement 4/91 – Bull. EC*
67 pp. * ECU 4.25 * ISBN 92-826-3025-0 * CM-NF-91-004-EN-C — 1992

Agriculture in Europe
97 pp. * ECU 7 * ISBN 92-826-0476-4 * CM-60-90-418-EN-C — 1992

Telecommunications in Europe, Herbert UNGERER with the collaboration of Nicholas P. COSTELLO
Revised edition, 1990
257 pp. * ECU 10 * ISBN 92-826-1640-1 * CM-59-90-346-EN-C — 1992

European Economy – No 35 – **The economics of 1992**
222 pp. * ECU 16 * ISSN 0379-0991 * CB-AR-88-035-EN-C — 1992

European Economy – No 40 – **Horizontal mergers and competition policy in the European Community**
98 pp. * ECU 16 * ISSN 0379-0991 * CB-AR-89-040-EN-C — 1992

European Economy – No 45 – **Stabilization, liberalization and devolution – Assessment of the economic situation and reform process in the Soviet Union**
191 pp. * ECU 18 * ISSN 0379-0991 * CB-AR-90-045-EN-C — 1992

European Economy – No 50 – **Annual Economic Report 1991-92 – Strengthening growth and improving convergence**
285 pp. * ECU 20 * ISSN 0379-0991 * CM-AR-91-050-EN-C — 1992

European Economy – Social Europe – **The impact of the internal market by industrial sector: the challenge for the Member States** – *Special edition – 1990*
340 pp. * ECU 18 * ISBN 92-826-1818-8 * CM-59-90-887-EN-C — 1992

Social Europe 3/91 – Equal opportunities for women and men
202 pp. * ECU 18 * ISSN 0255-0776 * CE-AA-91-003-EN-C — 1992

Guide to the reform of the Community's structural Funds
104 pp. * ECU 11.25 * ISBN 92-826-0029-7 * CB-56-89-223-EN-C — 1992

The rights of working women in the European Community, Eve C. LANDAU
244 pp. * ECU 5.25 * ISBN 92-825-5341-8 * CB-43-85-741-EN-C — 1992

European Economy – No 36 – **Creation of a European financial area – Liberalization of capital movements and financial integration in the Community**
212 pp. * ECU 16 * ISSN 0379-0991 * CB-AR-88-036-EN-C — 1992

1992: the European social dimension, Patrick VENTURINI
119 pp. * ECU 9.75 * ISBN 92-825-8703-7 * CB-PP-88-B05-EN-C — 1992

Research on the 'cost of non-Europe' – Basic findings
Volume 1 – **Basic studies: Executive summaries**
578 pp. * ECU 53.25 * ISBN 92-825-8605-7 * CB-PP-88-B14-EN-C — 1992

Volume 2 – **Studies on the economics of integration**
652 pp. * ECU 57 * ISBN 92-825-8616-2 * CB-PP-88-C14-EN-C — 1992

Volume 3 – **The completion of the internal market: A survey of European industry's perception of the likely effects**
309 pp. * ECU 25.50 * ISBN 92-825-8610-3 * CB-PP-88-D14-EN-C — 1992

Volume 4 – **The 'cost of non-Europe': Border-related controls and administrative formalities – An illustration in the road haulage sector**
280 pp. * ECU 22.50 * ISBN 92-825-8618-9 * CB-PP-88-E14-EN-C — 1992

Volume 5 (Parts A + B)
The 'cost of non-Europe' in public-sector procurement
Part A: 552 pp. * ISBN 92-825-8646-4 * CB-P1-88-F14-EN-C — 1992
Part B: 278 pp. * ISBN 92-825-8647-2 * CB-P2-88-F14-EN-C — 1992
Parts A + B: ECU 120 * ISBN 92-825-8648-0

Volume 6 – **Technical barriers in the EC: An illustration by six industries**
The 'cost of non-Europe': Some case studies on technical barriers
242 pp. * ECU 21 * ISBN 92-825-8649-9 * CB-PP-88-G14-EN-C — 1992

Volume 7 – **The 'cost of non-Europe': Obstacles to transborder business activity**
154 pp. * ECU 12.75 * ISBN 92-825-8638-3 * CB-PP-88-H14-EN-C — 1992

Volume 8 – **The 'cost of non-Europe' for business services**
140 pp. * ECU 13.50 * ISBN 92-825-8637-5 * CB-PP-88-I14-EN-C — 1992

Volume 9 – **The 'cost of non-Europe' in financial services**
494 pp. * ECU 120 * ISBN 92-825-8636-7 * CB-PP-88-J14-EN-C — 1992

Volume 10 – **The benefits of completing the internal market for telecommunication services equipment in the Community**
197 pp. * ECU 17.25 * ISBN 92-825-8650-2 * CB-PP-88-K14-EN-C — 1992

Volume 11 – **The EC 92 automobile sector**
350 pp. * ECU 27.75 * ISBN 92-825-8619-7 * CB-PP-88-L14-EN-C — 1992

Volume 12 (Parts A + B)
The 'cost of non-Europe' in the foodstuffs industry
Part A: 424 pp. * ISBN 92-825-8642-1 * CB-P1-88-M14-EN-C — 1992
Part B: 328 pp. * ISBN 92-825-8643-X * CB-P2-88-M14-EN-C — 1992
Parts A + B: ECU 120 * ISBN 92-825-8644-8

Volume 13 – **«Le coût de la non-Europe» des produits de construction**
168 pp. * ECU 14.25 * ISBN 92-825-8631-6 * CB-PP-88-N14-FR-C — 1992

Volume 14 – **'The cost of non-Europe' in the textile-clothing industry**
256 pp. * ECU 21.75 * ISBN 92-825-8641-3 * CB-PP-88-O14-EN-C — 1992

Volume 15 – **'The cost of non-Europe' in the pharmaceutical industry**
182 pp. * ECU 13.50 * ISBN 92-825-8632-4 * CB-PP-88-P14-EN-C — 1992

Volume 16 – **The internal markets of North America – Fragmentation and integration in the USA and Canada**
176 pp. * ECU 13.50 * ISBN 92-825-8630-8 * CB-PP-88-Q14-EN-C — 1992

Special price for the complete series: **ECU 360**

Commission of the European Communities
OFFICES

EIRE — IRELAND

Dublin

Commission of the European Communities
Office in Ireland

Jean Monnet Centre
39 Molesworth Street
Dublin 2
Tel. (353-1) 71 22 44
Fax (353-1) 71 26 57
Telex (0500) 93827 EUCO EI

UNITED KINGDOM

London

Commission of the European Communities
Office in the United Kingdom

Jean Monnet House
8 Storey's Gate
London SW1P 3AT
Tel. (44-71) 973 19 92
Fax (44-71) 973 19 00/19 10
Telex (051) 23208 EURUK G

Belfast

Commission of the European Communities
Office in Northern Ireland

Windsor House
9/15 Bedford Street
Belfast BT2 7EG
Tel. (44-232) 24 07 08
Fax (44-232) 24 82 41
Telex (051) 74117 CECBEL G

Cardiff

Commission of the European Communities
Office in Wales

4 Cathedral Road
Cardiff CF1 9SG
Tel. (44-222) 37 16 31
Fax (44-222) 39 54 89
Telex (051) 497727 EUROPA G

Edinburgh

Commission of the European Communities
Office in Scotland

9 Alva Street
Edinburgh EH2 4PH
Tel. (44-31) 225 20 58
Fax (44-31) 226 41 05
Telex (051) 727420 EUEDING

UNITED STATES OF AMERICA

Washington

Commission of the European Communities
External Delegation

2100 M Street, NW (Suite 707)
Washington DC 20037
Tel. (1-202) 862 95 00
Fax (1-202) 429 17 66
Telex (023) 64215 EURCOM NW

New York

Commission of the European Communities
External Delegation

3 Dag Hammarskjöld Plaza
305 East 47th Street
New York NY 10017
Tel. (1-212) 371 38 04
Fax (1-212) 758 27 18
Telex (023) 012396 EURCOM NY

JAPAN

Tokyo

Commission of the European Communities
External Delegation

Europa House
9-15 Sanbancho
Chiyoda-Ku
Tokyo 102
Tel. (81-3) 239 04 41
Fax (81-3) 239 93 37
Telex (072) 28567 COMEUTOK J

15/02/93

BELGIQUE/BELGIË
Bruxelles/Brussel
Commission des Communautés européennes
Commissie van de Europese Gemeenschappen
Bureau en Belgique/Bureau in België
Rue Archimédestraat 73
B-1040 Bruxelles/Brussel
Tél.: (32-2) 295 38 44
Fax: (32-2) 295 01 66
Télex: 26657 COMINF B

DANMARK
København
Kommissionen for De Europæiske Fællesskaber
Kontor i Danmark
Højbrohus
Østergade 61
Postbox 144
DK-1004 København K
Tlf.: (45-33) 14 41 40
Telefax: (45-33) 11 12 03/14 13 92
Telex: (055) 16402 COMEUR DK

FRANCE
Paris
Commission des Communautés européennes
Bureau de représentation en France
288, boulevard Saint-Germain
F-75007 Paris
Tél.: (33-1) 40 63 40 99
Fax: (33-1) 45 56 94 17/19
Télex: (042) CCEBRF202271F

Marseille
Commission des Communautés européennes
Bureau à Marseille
2, rue Henri-Barbusse
F-13241 Marseille Cedex 01
Tél.: (33) 91 91 46 00
Fax: (33) 91 90 98 07
Télex: (042) 402538 EURMA

LUXEMBOURG
Commission des Communautés européennes
Bureau au Luxembourg
Bâtiment Jean Monnet
Rue Alcide De Gasperi
L-2920 Luxembourg
Tél.: (352) 43 01-1
Fax: (352) 43 01 44 33
Télex: 3423/3446/3476 COMEUR LU

SUISSE/SCHWEIZ/SVIZZERA
Genève
Commission des Communautés européennes
Bureau de presse et d'information
Kommission der Europäischen Gemeinschaften
Presse- und Informationsbüro
Commissione delle Comunità europee
Ufficio stampa e informazione
Case postale 195
37-39, rue de Vermont
CH-1211 Genève 20 CIC
Tél.: (41-22) 734 97 50
Fax: (41-22) 734 22 36
Télex: (045) 414 165 ECOM CH

BR DEUTSCHLAND
Bonn
Kommission der Europäischen Gemeinschaften
Vertretung in der Bundesrepublik Deutschland
Zitelmannstraße 22
D-5300 Bonn 1
Tel.: (49-228) 53 00 90
Fax: (49-228) 530 09 50/12
Telex: (041) 886648 EUROP D

Berlin
Kommission der Europäischen Gemeinschaften
Vertretung in der Bundesrepublik Deutschland
Außenstelle Berlin
Kurfürstendamm 102
D-W-1000 Berlin 31
Tel.: (49-30) 896 09 30
Fax: (49-30) 892 20 59
Telex: (041) 184015 EUROP D

München
Kommission der Europäischen Gemeinschaften
Vertretung in der Bundesrepublik Deutschland
Vertretung in München
Erhardtstraße 27
D-8000 München 2
Tel.: (49-89) 202 10 11
Fax: (49-89) 202 10 15
Telex: (041) 5218135

ESPAÑA
Madrid
Comisión de las Comunidades Europeas
Oficina en España
Calle de Serrano, 41, 5.ª,
E-28001 Madrid
Tel.: (34-1) 435 17 00/435 15 28
Telecopia: (34-1) 576 03 87/577 29 23
Télex: (052) 46818 OIPE E

Barcelona
Comisión de las Comunidades Europeas
Oficina en España
Avenida Diagonal, 407 bis, 18.ª
E-08008 Barcelona
Tel.: (34-3) 415 81 77
Telecopia: (34-3) 415 63 11
Télex: (34-3) 4157044

VENEZUELA
Caracas
Comisión de las Comunidades Europeas
Delegación
Calle Orinoco, Las Mercedes
Apartado 67 076,
Las Américas 1061A
Caracas
Tel.: (58-2) 91 51 33
Telecopia: (58-2) 91 88 76
Télex: (031) 27298 COMEU VC

ΕΛΛΑΔΑ
Αθήνα
Επιτροπή των Ευρωπαϊκών Κοινοτήτων
Γραφείο στην Ελλάδα
Βασιλίσσης Σοφίας 2
Τθ 30284
GR-10674 Αθήνα
Τηλ.: (30-1) 724 39 82/83/84
Τέλεφαξ: (30-1) 724 46 20
Τέλεξ: (0601) 219324 ECAT GR

ITALIA
Roma
Commissione delle Comunità europee
Ufficio in Italia
Via Poli, 29
I-00187 Roma
Tel.: (39-6) 699 11 60
Telecopia: (39-6) 679 16 58/52
Telex: (043) 610184 EUROMA I

Milano
Commissione delle Comunità europee
Ufficio a Milano
Corso Magenta, 59
I-20123 Milano
Tel.: (39-2) 480 15 05/06/07/08
Telecopia: (39-2) 481 85 43
Telex: (043) 316200 EURMIL I

NEDERLAND
Den Haag
Commissie van de Europese Gemeenschappen
Bureau in Nederland
Korte Vijverberg 5
2513 AB Den Haag
Nederland
Tel.: (31-70) 346 93 26
Telecopie: (31-70) 364 66 19
Telex: (044) 31094 EURCO NL

PORTUGAL
Lisboa
Comissão das Comunidades Europeias
Gabinete em Portugal
Centro Europeu Jean Monnet
Largo Jean Monnet, 1-10.º
P-1200 Lisboa
Tel.: (351-1) 54 11 44
Telecopiador: (351-1) 55 43 97
Telex: (0404) 18810 COMEUR P

ORDER FORM

for European Economy and Supplements

ORDER FORM

European Economy ISSN 0379-0991

Number of copies: .....

Price annual subscription (4 issues per year):
ECU 84

European Economy + Supplements A and B

Price combined annual subscription:
ECU 126 .....

Name and address:

Date: ..... Signature: .....

ORDER FORM

Supplements to 'European Economy'.

Number of copies:

Series A — **Recent economic trends**
Price annual subscription (11 issues per year):
ECU 34 .....

Series B — **Economic prospects — business survey results**
Price annual subscription (11 issues per year):
ECU 34 .....

Price both supplements:
ECU 68 .....

Name and address:

Date: ..... Signature: .....

ORDER FORM

European Economy ISSN 0379-0991

Number of copies: .....

Price annual subscription (4 issues per year):
ECU 84

European Economy + Supplements A and B

Price combined annual subscription:
ECU 126 .....

Name and address:

Date: ..... Signature: .....

Office des
publications officielles
des Communautés européennes

L-2985 **Luxembourg**

Office des
publications officielles
des Communautés européennes

L-2985 **Luxembourg**

Office des
publications officielles
des Communautés européennes

L-2985 **Luxembourg**

Venta y suscripciones • Salg og abonnement • Verkauf und Abonnement • Πωλήσεις και συνδρομές
Sales and subscriptions • Vente et abonnements • Vendita e abbonamenti
Verkoop en abonnementen • Venda e assinaturas

BELGIQUE / BELGIË

Moniteur belge / Belgisch Staatsblad
Rue de Louvain 42 / Leuvenseweg 42
B-1000 Bruxelles / B-1000 Brussel
Tél. (02) 512 00 26
Fax (02) 511 01 84

Autres distributeurs / Overige verkooppunten

Librairie européenne/ Europese boekhandel
Rue de la Loi 244/Wetstraat 244
B-1040 Bruxelles / B-1040 Brussel
Tél. (02) 231 04 35
Fax (02) 735 08 60

Jean De Lannoy
Avenue du Roi 202 /Koningslaan 202
B-1060 Bruxelles / B-1060 Brussel
Tél. (02) 538 51 69
Télex 63220 UNBOOK B
Fax (02) 538 08 41

Document delivery:
Credoc
Rue de la Montagne 34 / Bergstraat 34
Bte 11 / Bus 11
B-1000 Bruxelles / B-1000 Brussel
Tél. (02) 511 69 41
Fax (02) 513 31 95

DANMARK

J. H. Schultz Information A/S
Herstedvang 10-12
DK-2620 Albertslund
Tlf. 43 63 23 00
Fax (Sales) 43 63 19 69
Fax (Management) 43 63 19 49

DEUTSCHLAND

Bundesanzeiger Verlag
Breite Straße 78-80
Postfach 10 80 06
D-W-5000 Köln 1
Tel. (02 21) 20 29-0
Telex ANZEIGER BONN 8 882 595
Fax 2 02 92 78

GREECE/ΕΛΛΑΔΑ

G.C. Eleftheroudakis SA
International Bookstore
Nikis Street 4
GR-10563 Athens
Tel. (01) 322 63 23
Telex 219410 ELEF
Fax 323 98 21

ESPAÑA

Boletín Oficial del Estado
Trafalgar, 29
E-28071 Madrid
Tel. (91) 538 22 95
Fax (91) 538 23 49

Mundi-Prensa Libros, SA
Castelló, 37
E-28001 Madrid
Tel. (91) 431 33 99 (Libros)
431 32 22 (Suscripciones)
435 36 37 (Dirección)
Télex 49370-MPLI-E
Fax (91) 575 39 98

Sucursal:
Librería Internacional AEDOS
Consejo de Ciento, 391
E-08009 Barcelona
Tel. (93) 488 34 92
Fax (93) 487 76 59

Llibreria de la Generalitat de Catalunya
Rambla dels Estudis, 118 (Palau Moja)
E-08002 Barcelona
Tel. (93) 302 68 35
302 64 62
Fax (93) 302 12 99

FRANCE

Journal officiel
Service des publications des Communautés européennes
26, rue Desaix
F-75727 Paris Cedex 15
Tél. (1) 40 58 75 00
Fax (1) 40 58 77 00

IRELAND

Government Supplies Agency
4-5 Harcourt Road
Dublin 2
Tel. (1) 61 31 11
Fax (1) 78 06 45

ITALIA

Licosa SpA
Via Duca di Calabria 1/1
Casella postale 552
I-50125 Firenze
Tel. (055) 64 54 15
Fax 64 12 57
Telex 570466 LICOSA I

GRAND-DUCHÉ DE LUXEMBOURG

Messageries du livre
5, rue Raiffeisen
L-2411 Luxembourg
Tél. 40 10 20
Fax 40 10 24 01

NEDERLAND

SDU Overheidsinformatie
Externe Fondsen
Postbus 20014
2500 EA 's-Gravenhage
Tel. (070) 37 89 911
Fax (070) 34 75 778

PORTUGAL

Imprensa Nacional
Casa da Moeda, EP
Rua D. Francisco Manuel de Melo, 5
P-1092 Lisboa Codex
Tel. (01) 69 34 14

Distribuidora de Livros Bertrand, Ld.ª
Grupo Bertrand, SA
Rua das Terras dos Vales, 4-A
Apartado 37
P-2700 Amadora Codex
Tel. (01) 49 59 050
Telex 15798 BERDIS
Fax 49 60 255

UNITED KINGDOM

HMSO Books (Agency section)
HMSO Publications Centre
51 Nine Elms Lane
London SW8 5DR
Tel. (071) 873 9090
Fax 873 8463
Telex 29 71 138

ÖSTERREICH

Manz'sche Verlags- und Universitätsbuchhandlung
Kohlmarkt 16
A-1014 Wien
Tel. (0222) 531 61-0
Telex 112 500 BOX A
Fax (0222) 531 61-39

SUOMI/FINLAND

Akateeminen Kirjakauppa
Keskuskatu 1
PO Box 128
SF-00101 Helsinki
Tel. (0) 121 41
Fax (0) 121 44 41

NORGE

Narvesen Info Center
Bertrand Narvesens vei 2
PO Box 6125 Etterstad
N-0602 Oslo 6
Tel. (22) 57 33 00
Telex 79668 NIC N
Fax (22) 68 19 01

SVERIGE

BTJ
Tryck Traktorwägen 13
S-222 60 Lund
Tel. (046) 18 00 00
Fax (046) 18 01 25
30 79 47

SCHWEIZ / SUISSE / SVIZZERA

OSEC
Stampfenbachstraße 85
CH-8035 Zürich
Tel. (01) 365 54 49
Fax (01) 365 54 11

ČESKÁ REPUBLIKA

NIS ČR
Havelkova 22
130 00 Praha 3
Tel. (2) 235 84 46
Fax (2) 235 97 88

MAGYARORSZÁG

Euro-Info-Service
Club Sziget
Margitsziget
1138 Budapest
Tel./Fax 1 111 60 61
1 111 62 16

POLSKA

Business Foundation
ul. Krucza 38/42
00-512 Warszawa
Tel. (22) 21 99 93, 628-28-82
International Fax&Phone
(0-39) 12-00-77

ROMÂNIA

Euromedia
65, Strada Dionisie Lupu
70184 Bucuresti
Tel./Fax 0 12 96 46

BĂLGARIJA

Europress Klassica BK Ltd
66, bd Vitosha
1463 Sofia
Tel./Fax 2 52 74 75

RUSSIA

Europe Press
20 Sadovaja-Spasskaja Street
107078 Moscow
Tel. 095 208 28 60
975 30 09
Fax 095 200 22 04

CYPRUS

Cyprus Chamber of Commerce and Industry
Chamber Building
38 Grivas Dhigenis Ave
3 Deligiorgis Street
PO Box 1455
Nicosia
Tel. (2) 449500/462312
Fax (2) 458630

TÜRKIYE

Pres Gazete Kitap Dergi Pazarlamá Dağitim Ticaret ve sanayi AŞ
Narlibahçe Sokak N. 15
Istanbul-Cağaloğlu
Tel. (1) 520 92 96 - 528 55 66
Fax 520 64 57
Telex 23822 DSVO-TR

ISRAEL

ROY International
PO Box 13056
41 Mishmar Hayarden Street
Tel Aviv 61130
Tel. 3 496 108
Fax 3 544 60 39

UNITED STATES OF AMERICA / CANADA

UNIPUB
4611-F Assembly Drive
Lanham, MD 20706-4391
Tel. Toll Free (800) 274 4888
Fax (301) 459 0056

CANADA

Subscriptions only
Uniquement abonnements
Renouf Publishing Co. Ltd
1294 Algoma Road
Ottawa, Ontario K1B 3W8
Tel. (613) 741 43 33
Fax (613) 741 54 39
Telex 0534783

AUSTRALIA

Hunter Publications
58A Gipps Street
Collingwood
Victoria 3066
Tel. (3) 417 5361
Fax (3) 419 7154

JAPAN

Kinokuniya Company Ltd
17-7 Shinjuku 3-Chome
Shinjuku-ku
Tokyo 160-91
Tel. (03) 3439-0121

Journal Department
PO Box 55 Chitose
Tokyo 156
Tel. (03) 3439-0124

SOUTH-EAST ASIA

Legal Library Services Ltd
STK Agency
Robinson Road
PO Box 1817
Singapore 9036

AUTRES PAYS
OTHER COUNTRIES
ANDERE LÄNDER

Office des publications officielles des Communautés européennes
2, rue Mercier
L-2985 Luxembourg
Tél. 499 28-1
Télex PUBOF LU 1324 b
Fax 48 85 73/48 68 17

Price (excluding VAT) in Luxembourg		
	ECU	
European Economy (4 issues per year)	84	The annual subscription runs from 1 January to 31 December of each year
Supplements		
Series A — 'Recent economic trends' (11 issues per year)	34	Prices for single copies may be obtained from the sales offices
Series B — 'Business survey results' (11 issues per year)	34	
Both supplements	68	These are surface mail rates; for air subscription rates please apply to the sales offices
Combined subscription — *European Economy* and supplements	126	

OFFICE FOR OFFICIAL PUBLICATIONS
OF THE EUROPEAN COMMUNITIES

L-2985 Luxembourg

CM-AR-92-052-EN-C