Europe: 1992 and the Developing World

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Foreword

This book looks at the impact of the Single European Market (SEM) on the developing countries, a subject neglected in the abundance of studies done or commissioned by the European Commission as material for the famous Cecchini Report (Cecchini, 1988). It concentrates on those aspects of the 1992 programme where something precise can be said about the impact on the developing countries — trade diversion and creation, the elimination of existing member state quotas or privileged access for goods from particular countries, the harmonisation of indirect taxes in the European Community and changes in trade in services. When plausible, an attempt is made to quantify the effects.

One important conclusion is that 1992 will affect different developing countries in very different ways. The study takes a sample of 10 countries and looks in some detail at the effects of the 1992 programme on them. It is clear that no simple ranking of the effects is valid for all.

The study has benefited from several other pieces of research which the authors have undertaken over the last year and a half. Two of these concern the impact of 1992 on the developing countries signatory to the Lomé Convention and were undertaken for the European Centre for Development Policy Management (ECDPM) at Maastricht (Davenport and Stevens, 1990; Page, 1990). The study by Davenport (1990) for the Netherlands Ministry of Foreign Affairs on developing country manufactured exports and that by Davenport and Page (1989) for UNCTAD have also been useful. The absence of any Latin American country in the sample of specific countries examined will be rectified in a study of the effects of the Single European Market on Central America, undertaken by the European Institute for Public Administration in Maastricht, to which both the authors are contributing. In addition, Page prepared a report for the OECD Development Centre on 'Some Implications of Europe 1992 for Developing Countries', while Davenport presented a paper on 1992 and the exports of manufactures to the World Bank Economic Development Institute Conference in 1989. Both authors are contributing to a book of conference proceedings on 'The Impact of 1992 on the Third World', to be published in 1991 under the auspices of the European Association of Development Research and Training Institutes (EADI).

Michael Davenport wrote the greater part of the study. Sheila Page contributed to several sections, in particular those on the Multifibre Arrangement and trade in services, and wrote the second section of the chapter on the making of policy (Chapter 8). That section is an abbreviated version of her contribution to the book to be published under the auspices of EADI.

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London, November 1990

General Notes

1. In all statistics and calculations the term 'ACP' refers to the then 68 signatories of the Fourth Lomé Convention. In many of the calculations the overseas territories of the EC member states are included with the ACP states but in each case when that is done it is made explicit.
2. The value of the ecu was as follows:

average 1987	\$US 1.146 £ 0.707
average 1988	\$US 1.176 £ 0.667
average 1989	\$US 1.101 £ 0.674
10 November 1990	\$US 1.387 £ 0.706

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Introduction and Findings

Introduction: is 1992 history?

This study examines the effects of the 1992 programme for the Single European Market on the developing countries. Where it has been possible to quantify the results they have not been found to be dramatic, amounting to 7 bn ecu or 5.3% of their exports of goods and services to the European Community. This is not much more than 0.25% of their GDP — rather little in view of the European Commission's promises that 1992 would give a significant boost to the developing countries. Most of the gain comes from the effect of higher GDP in the Community on their exports.

However, there remain many potential and incalculable repercussions. How much direct investment is being and will be redirected from the developing countries towards the European Community as multinational companies decide that they must operate within a possible ringfence? To what extent will the Community become protectionist — the infamous fortress Europe — to force the burden of adjustment to the single market on to foreign exporters? To what extent will the Community's new strength as a united trading bloc further weaken the multilateral trading system which the developing countries desperately need in order to shore up their weakness vis-à-vis the industrial countries? These questions cannot be answered unambiguously but the analysis demonstrates the fragility of the small measurable gains from the 1992 programme.

The origins of the programme lie in the paralysis of the European integration process in the 1970s. But there is nothing new in the idea of a Single European Market (SEM). It was the goal of the 1957 Treaty of Rome. In practice, however, although internal customs duties were quickly abolished, the Community has remained fragmented by a multitude of administrative barriers separating the member states. Efforts to eliminate these have been piecemeal and often bogged down in technical detail.

On a request from the European Council, the Commission submitted its famous White Paper on 'Completing the Internal Market' in 1985. The Single European Act of 1987 re-established the goal of 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured' and simplified the procedures for reaching this goal by introducing qualified majority voting in the Council for all proposals other than those relating to fiscal policy or the movement of individuals between countries, where unanimity is still required. In early 1988, almost three years after the White Paper, the Commission published a series of studies, some sectoral and some 'horizontal', of the impact of the 1992 programme on the member states. These were brought together into an overall quantitative assessment in the Cecchini Report (Cecchini, 1988) and in the more technical and comprehensive 'Economics of 1992' (Commission, 1988a).

The Cecchini Report dismisses the consequences of 1992 for the outside world as 'a much-needed shot in the arm for other markets and economies in less buoyant shape' (p.XIX). Certainly increased incomes in the Community generated by the integration of the market will tend to boost imports. But the effects on the outside world will be considerably more complex and more ambiguous. First, the internal gains and the external impacts of the programme critically depend on the response of the EC economy to the opportunities that integration will provide. Secondly, crucial decisions about how the programme is to be implemented have still to be taken. Thirdly, the evolution of future EC trade policy will to some extent be conditioned by the problems of the adjustment of the member states, and perhaps of third countries, to the SEM. Fourthly, it will be largely up to the Third World to exploit the opportunities of the wider, more integrated market and to meet the challenges of more intense competition or tougher technical standards.

In the two and a half years that have passed since the Cecchini Report was published, the developing countries have become increasingly anxious about how they may be affected by the SEM. Inevitably their concerns focus on those aspects of the 1992 programme which threaten their access to the Community market. The large number of new Community regulations and directives touching agricultural goods and food products have created anxiety and often bewilderment as officials fail to understand their technical details. Often there is a natural suspicion that they are being put into place with a view to making outsiders' access to the Community market more difficult.

Successive statements by Commissioners do not inspire confidence. Unexceptionable remarks like 'it would be absurd for the EC to lean towards protectionism' often have a sting in the tail like 'it would be premature, however, to grant non-member countries automatic and unilateral access to the benefits of the internal liberalisation process before such new agreements [on areas like services] exist' (quoted in Stoeckel et al., 1990, p.38). In the Uruguay Round negotiations, the efforts of the Community to resist liberalisation in most areas of trade and to toughen up safeguard procedures allowed under the GATT can give the developing countries no confidence that it puts much value on their rights of access. The Single European Market may end up, in the words of the president of the European Commission, Jacques Delors, as 'ni forteresse, ni passoire' (neither fortress, nor Easy Street), but where it settles on the broad intermediate spectrum of more or less liberal trade is critical.

This study sets out to quantify the effects of the SEM on the developing countries to the extent that such quantification seems valid. In some cases where effects cannot be quantified because important decisions have yet to be taken, alternative plausible outcomes are simulated. In other cases the issues can only be treated in a qualitative way, for example because it is impracticable to try to put numbers on the flexibility with which producers in the developing countries confront new problems and challenges in their access to the SEM or on the willingness with which EC policy-makers will listen to demands from their own producers for more protection against 'unfair' competition from abroad.

Although a number of directives in the 1992 programme have still not been agreed, including some areas of particular interest to the developing countries, the underlying assumption of this study will be that the integration of the EC market will be fully achieved along the lines of the 1985 White Paper. The Commission has now completed the task of laying before the Council of Ministers all the directives it deems necessary for the 'Completion of the Single European Market'. The initial programme called for 279 proposals to the Council for new EC law or modifications to existing law. Some 60% of these have been adopted by the Council. A few have been rejected, the most important being those on the rapid harmonisation of EC indirect taxation. But it does now seem probable that the remainder will be adopted by the Council in good time, even if not always as originally proposed by the Commission.

The main legislative bottleneck now is their 'transposition' or incorporation into national law in the member states in those cases where new EC law is not implemented automatically. In some countries progress has been slower than in others, with Italy having the greatest backlog since improvements were made in Spain and Portugal. However, the new 'La Pergola' law, under which most of the backlog is to be incorporated within national law in a single act, should allow Italy largely to catch up. Another concern is the lack of compliance with the European Court judgements on existing single market legislation. By March 1990 the Court had initiated 70 infringement procedures under Article 171 of the Treaty of Rome, 20 of them against Italy. Clearly many other Court judgements have been ignored in the member states but these do not always give rise to complaints, while in other cases the member state has assured the Court that remedial action is about to be taken (Commission, 1990: Annex 4).

But the fact that there are serious delays with the implementation of the legislation, and indeed that some of the 1992 programme, for example the elimination of all frontier controls on persons, may not see the light of day for many years (and some would hope never), does not mean that there is more 'hype' than reality. There certainly was plenty of hype in the early days but it created its own reality. The fact that certain parts of the programme may not be realised may well limit the ultimate effectiveness of the whole project, but the essentials are in place. Businesses and governments, both inside and outside the Community, now take the SEM project seriously, and this means it will change attitudes and ways of producing things and doing business — and indeed is already doing so.

If the Community is to become a genuine integrated market comparable, say, to the United States, a lot more than 279 pieces of legislation are required, though those which deal with the elimination of border controls (on goods) and the harmonisation of taxes are clearly crucial. It will be some time before producers and consumers adopt a truly Community perspective and cease to see the member state as a factor in the location of production or the origin of goods. But that has not stopped business adapting and anticipating the SEM. Intra-EC trade has picked up as a share of member state exports after declining between 1973 and 1985. Capital investment has been strong and well above trend in the last few years. Spain and Portugal have experienced particularly rapid investment growth at over 10% both in 1988 and 1989 against EC averages of 8.3 and 6.9%. A 1989 survey of firms in all member states showed that 31% of industrial firms expected completion of the internal market to exert a favourable impact on investment.

> The question thus arises whether the steep rise in investment in the EC in 1988 can already be partly ascribed to a '1992 effect', or whether it is merely the result of increased demand and the improved return on capital. Given the time lags between investment decisions and putting these decisions into effect ..., businesses would need to have become aware of the prospects offered by 1992 shortly after the publication of the White Paper, namely in 1986-87....Such an assumption does not look unrealistic in the light of trends of mergers by acquisition observed between 1985-86 and 1986-87.... Another factor that confirms the above assumption is the downward bias in investment forecasts ... This suggests that the underestimation measures the impact of not taking into account the '1992 effect'. (Commission, 1989, p.201)

If the investment effect of the 1992 programme within the Community has to some extent already taken place, a part of the general trade effects on the rest of the world will also have already occurred. The increased investment will have stimulated increased imports both directly from the developing countries, among others, and indirectly, through its multiplier effects on national income and all its demand components. However, this study will not try to assess the extent to which trade creation or trade diversion has already come about. Even if well-articulated econometric models were available for each member state, or for the Community as a whole, it is doubtful if the 1992 effects could be plausibly isolated. Nor does it consider the economic effects of moves towards, or arrival at, monetary union, which was conceived separately from the Single European Market and is analytically a different issue. That is not to say that the economic implications of realising the two goals may not reinforce one another. But the SEM is quite far on the way to implementation while monetary union is still a distant target. We decided therefore to concentrate the study on the former.

Findings of the study: identifiable effects

We start with those effects which we have thought appropriate to seek to quantify. Table 1.1 gathers our estimates, regardless of how

Table 1.1
Estimates of the impact of 1992 *(based on 1987 data)*

	EC imports[a] from ldcs m. ecu	*ldc share in EC imports*	*EC imports as % ldc expts.*	*1992 effects[b] m.ecu*
Merchandise trade:				
creation, primary goods	60,864	26.7	31.9	3,223
creation, manufactures	45,842	7.8	21.5	4,434
diversion, manufactures				-4,651
terms of trade effects[c]				733
sub-total				3,739
Horticultural, fishery products: member state quotas abolished	1,344	n.a	n.a	350
Textiles[d]: member state quotas abolished	10,571	50.4	19.0[e]	439
Elimination of excise taxes, 5% VAT				
Coffee	4,646	99.1	42.6	253
Cocoa[f]	645	98.1	50.7	52
Tea	1,457	100.0	68.6	6
Harmonisation of taxes				
Tobacco	1,969	54.2	44.9	-63
Bananas[g]	1,563	100.0	35.6	142
Services:				
trade expansion effects	22,705	4.1	9.8	1,227
price of EC services[h]				636
Totals	131,974[i]			6,781

Notes

a. imports are measured cif. Ldcs follow UNCTAD definition plus Taiwan and China.
b. presented as point estimates rather than ranges since they have differing and incalculable margins of error.
c. merchandise imports by ldcs from EC are estimated at 89 bn ecu or 25.8% of total ldc imports.
d. products subject to member state QRs or subquotas.
e. 1985.
f. including cocoa products.
g. includes effects of EC exporting territories: deficiency payments (EC 700 ecu/tonne, ACP 500 ecu/tonne) with quotas on dollar bananas and ETC of 14%.
h. services imports by ldcs from EC are estimated at 25 bn ecu or 7.1% of all ldc imports.
i. estimate of total exports of goods and services to the EC.

crude they may be. The first column of the table gives the actual flows of trade in goods or services on which the estimates of the 1992 effects, given in the final column, are based. The second and third columns give statistics on the market share of the developing countries in EC imports and EC imports as a share of their exports in each aggregate.

The major quantifiable effects are on flows of merchandise trade in volume terms through the processes of **trade creation and diversion**, respectively the increased demand for exports generated by increased incomes and output in the EC and the reduction in demand occasioned by the improved productivity of the EC's own capital stock. Secondly, there are **terms of trade effects**, which comprise, first, the repercussions on developing countries' exports of rises in prices of primary goods induced by that rise in Community demand and, secondly, the lower import bills from lower EC export prices for manufactures. Details of how these estimates are derived are given in Chapter 2.

They are presented as point estimates rather than ranges since they all have differing and incalculable margins of error. Arguably a range should be given for the trade creation and diversion and terms of trade effects, using the Cecchini band of estimates of the GDP impact in the EC of from 4.25 to 6.5%, rather than our point assumption of 5%. It would imply that the general trade effects ranged from 3.2 to 4.9 bn ecu rather than the single figure of 3.7 bn ecu, or in percentage terms 2.4% to 3.7% of developing countries' exports of goods and services to the Community.

Even taking the higher figure of 3.7%, Cecchini's 'shot in the arm' looks like pretty weak medicine. Or to use a more popular metaphor, the 'rising tide' of economic activity in the EC will not carry the developing countries far up the beach. Along with Cecchini we have taken as our central thesis that the SEM results in a once-and-for-all boost to Community GDP. On the other hand, there is the argument advanced by Baldwin (1989) for example, that the SEM could lead, through an intensified flow of innovations, new processes and new products, to a higher long-term EC growth rate. If this were to happen, both trade creation and diversion would increase, but as long as creation dominates, the developing countries could experience a long-term increase in the growth of their exports. However, this argument remains speculative.

Taking our figures, the trade creation is largely offset by trade diversion. Indeed, in manufacturing trade diversion exceeds trade creation. One threat to our overall small, but, at least, positive, total effect at the foot of Table 1.1 is the fact that trade diversion may be significantly underrated using traditional customs union analysis. Reaching a Single European Market is not the same as forming a customs union, though there are clear analogies. The SEM means eliminating conventional non-tariff barriers including public procurement regulations, national standards and indirect taxes, all border controls and restrictions on capital and labour movements within the Community. Our 'tariff equivalents' to individual barriers may seriously underestimate their brake on intra-EC trade and, if the SEM leads to a fully integrated market, comparable to that of the United States, the total impact may be greater than the sum of its parts. For example, while no estimate of diversion in services has been undertaken since the developing countries export little in the way of services (except tourism) to the EC, a single EC market in services could give a major boost to productivity in manufacturing and indirectly magnify the degree of trade diversion.

Another threat is a problem of perception. Any net positive general trade effects will be spread out over a number of years. Indeed, they may well have largely happened already. They will not be readily distinguished from the usual fluctuations in trade between North and South which tend to follow the business cycle in the developed countries. The SEM will get little credit for raising developing countries' exports to the EC or improving their terms of trade. On the other hand, the sectoral effects which may come from the elimination of controls on their exports or the imposition of new controls will be much more obviously 1992 effects.

The quantified sectoral effects depend on the **elimination of quantitative restrictions** (QRs) on developing countries' exports (horticultural goods, bananas, textiles) and **excise taxes** (tropical beverages). They assume no new QRs, though in Chapter 3 it is argued that new quotas (or 'voluntary' export restraints) on, at least, Taiwanese and South Korean shoes may be imminent. In general these calculations presume that there will be no new tendency towards more protectionism, no 'fortress'. But there is a danger that the EC will produce a protectionist reaction to the internal adjustment problems that will become increasingly acute up to and beyond 1992. The temptation to pass on the burden of adjustment will grow. Developing countries are least able to threaten retaliation against neo-protectionism and are most vulnerable. The EC track record on voluntary export restraints

(VERs), or anti-dumping or other discriminatory protectionist devices is not good. The official statements on reciprocity are disquieting. The EC proposals to the GATT Negotiating Group on Textiles confirm these worries (see Chapter 3).

Trade creation in services is more powerful, relative to services trade, than that in goods. The increase in developing countries' services exports is mainly in the tourism field where sensitivity of demand to increased incomes is high. The benefits from the falling prices of EC services exports stem mainly from the expected sizeable cuts in the prices of EC financial services, the area, according to the Cecchini Report, where opportunities for deregulation and restructuring are greatest. These effects are discussed in Chapter 5.

Turning to areas where no quantification has been attempted, on the basis of the patchy and unreliable data on **direct foreign investment** currently available, it is difficult to identify evidence of diversion. However, foreign investment fluctuates wildly under the impact of economic and political factors, some of which are discussed in Chapter 5. Foreign direct investment in the developing countries has been weak in recent years but it is plausible that other factors, including debt problems and low commodity prices (except recently for minerals), have been equally or more important in deterring investment than the improved prospects of Europe 1992.

In the area of **technical standards**, the principal worries for the developing countries concern agricultural and manufactured foods exports. New rules on fish health and hygiene and canned fish could pose problems, particularly in Africa and South-East Asia. In plant health no major new phyto-sanitary directives are being proposed but there will be a significant tightening of existing controls. Some countries, again largely in Africa, have cause to be anxious about those on food hygiene and meat products. The new standards can certainly be met. The question is primarily one of, first, whether the technical expertise for doing so cost-effectively is available in the exporting country and, secondly, of investment costs. Many countries complain about the lack of information about the technical details required to meet the new norms.

The principle of EC standards for meat, fish and plant health and food hygiene is difficult to challenge, particularly when it is argued that the same rules are being applied to third countries as are applied within the EC. Nevertheless there are justifiable concerns. The new regulations, and the strengthening of the inspectorate system, could lead to bureaucratic harassment of outside suppliers.

In some cases deliberate protectionism could masquerade under stringent monitoring of health and hygiene rules. In most cases it will probably be a problem of over-zealous officials who will demand higher standards of shipments from overseas than would be demanded of EC goods. Unfortunately it is the developing country suppliers who are likely to suffer most.

Effects on specific developing countries

Table 1.2 sets out estimates of trade creation and diversion for eight countries. Because these are countries with a higher mix of manufactures in their exports than that for the developing countries as a whole the net effects are pretty small — and even negative in the case of Malaysia. The overall effects sum to between a negative 0.9% of exports for Malaysia and a positive 2.6% for Côte d'Ivoire. The less the present significance of its manufacturing exports the more the country will benefit from the locomotive effect of 1992. There will be positive terms of trade effects for these countries, but as we argue in Chapter 2, the terms of trade effects of the SEM are less assured than the effects of real trade flows.

The effects of 1992 on specific countries will depend not only on what they produce and export but on 1992-imposed changes in their traditional trade links with individual EC member states. Certain countries, particularly ex-French colonies in Africa (including, in our sample, Morocco, Tunisia and Côte d'Ivoire), have been enjoying special access to the French market through the French system of QRs on horticultural and fishery products. Regardless of how beneficial to the long-term development process these special arrangements may have been, these countries will soon have to face tougher competition in their principal, often their only existing, market for the goods in question.

Other special trade privileges for 'traditional' suppliers will disappear. The ACP producers of bananas and those in the EC overseas territories are the most serious cases. No matter what new banana regime is instituted to preserve their special access, and massive aid payments notwithstanding, the least efficient of them, especially the Windward Islands and the French overseas territories, will suffer major economic upheavals with possible social and political implications. Being more efficient than most of the ACP or EC banana producers, Côte d'Ivoire (and Cameroon) will suffer less under any of the plausible banana regimes.

Table 1.2
Estimates of trade creation and diversion for individual developing countries
(m. ecu, based on 1987 data)

	Morocco	*Tunisia*	*Côte d'Ivoire*	*Kenya*	*Zimbabwe*	*Sri Lanka*	*Malaysia*	*Thailand*
Trade creation								
Primary goods	24	26	41	9	9	4	44	22
Manufactures	99	96	12	5	14	18	112	106
sub-total	123	123	53	14	24	22	156	128
Trade diversion (manufactures)	-106	-108	-16	-7	-20	-16	-163	-100
Net total	17	15	37	7	4	6	-7	28
as % exports to EC	0.8	0.9	2.6	1.2	1.3	2.0	-0.9	1.5

The relaxation of the EC restrictions on imports of textiles and clothing through the Multifibre Arrangement (MFA) will bring mixed blessings for the developing country exporters of these products, who are now the majority. Those not subject to MFA restrictions, including the Mediterranean and Lomé countries, will be faced with more acute competition. Those who are under the MFA will gain some flexibility depending on the extent to which their existing quotas are unevenly utilised across the member states. Of our sample of countries, Sri Lanka is a clear gainer while there is little in the change in system for Malaysia. There is no sense in which the distribution of gains can be said to be in any way rational.

There will be gains to coffee, tea and cocoa exporters from the elimination of EC excise taxes on these goods. In the case of coffee, where taxes are currently highest and the value of trade greatest, the gains are significant. The fact that the elimination of these taxes has been 'hijacked' by the Uruguay Round negotiators to beef up the EC offer on tropical products does not mean that it is not essentially a 1992 effect.

The harmonisation of taxes on tobacco products will probably lead to an increase in average excise tax levels. But if Zimbabwe, or other tobacco-exporting countries, can adjust the mix of tobacco varieties to meet the evolving demand for lighter cigarettes, they may be able to slow down the loss of exports. Fortunately for Zimbabwean export earnings, world consumption of tobacco is still growing.

For countries such as Malaysia and Thailand which are rapidly expanding their exports of manufactures, apart from clothing and textiles, any possible gains from the 1992 programme are clouded by the threat of increased EC protection. This may be undertaken in 'reprisal' for their failing to open their markets sufficiently to EC exports in return for the benefits that the SEM will bring them, or simply as a means of resolving 1992-related adjustment problems (a euphemism for sectoral or regional unemployment) in the Community. These countries, and others in Latin America and South-East Asia, are slowly moving in the direction of more open and less interventionist trade policies (Chunanuntathum et al., 1990). EC moves towards protection could set this process back and encourage a return to import substitution and export subsidies. The same can be said of EC policy over the MFA. The Community's efforts to get tougher and more selective 'disciplines' through the safeguard and anti-dumping procedures could perversely result in more inward-looking trade policies among the developing countries.

Changes in the world trading system

The international trading system and its institutions, particularly the GATT, will inevitably be changed by steps towards the SEM and the greater cohesion among EC member states that these have already established. However, the nature of the change will only become apparent over some years.

There have been identifiable **effects on the Uruguay Round** negotiations.[1] In the short term, Community attention has been largely pre-empted by the 1992 programme, which has been seen as more urgent and more significant for the EC economy. Commitment to the success of the Round has suffered with damaging consequences on the degree of trade liberalisation and on the interests of the developing countries. On the other hand, the fact that the Uruguay Round negotiations were taking place during much of the run-up to 1992 has probably inhibited the EC, in particular the Commission, from less liberal, more protectionist 1992-related actions on textiles and clothing (fewer new restrictions when member state MFA sub-quotas are eliminated), and also on shoes and bananas, though new trading regimes in these two cases have yet to be determined.

The Uruguay Round negotiations themselves have also been affected. An example is the negotiations on amending the GATT anti-dumping code. Worries about Community use of anti-dumping action, and the surge of actions against Japanese assembly plants based on imported components ('screwdriver' plants) in the EC, themselves related to 1992, have led a group of developing countries, piloted by Hong Kong, to make a strong attack on the arbitrary and biased EC regulations. On the other hand, the Community has tried to get the code amended to facilitate actions against screwdriver plants and also to allow single actions against groups of exporting firms on the basis of samples.

The package of Community SEM legislation has brought **new areas into international negotiation**, particularly services, and that experience has been useful in the Uruguay Round negotiations on services. Services are now established as a proper area for multilateral negotiation and liberalisation. The same may happen for technical standards.

There has been a GATT standards code for some years but it has been restricted to general principles. The Community's moves to establish detailed health and safety standards where seen as necessary, and otherwise the principle of mutual recognition, could serve as a precedent for moves in future negotiations to generalise the standards and the principle over a range of countries. In such ways the SEM, through its discretionary and imposed rules on imports from third countries, may in fact further the cause of a rule-based rather than a discretionary system. At the very least, it could lead to an increased ability and willingness to identify the protective effects of other countries' arrangements. Of course, there would be costs and benefits. The wider adoption of technical standards presents difficulties for exporters, but they may well gain more through the certainty that a product acceptable in one country will also be acceptable in a range of others.

These would be positive longer-term effects. But the SEM also carries a **threat of damage to the multilateral system**. The Community's new self-confidence in international trade matters, the urgency to make 1992 'work' together with the protectionist instincts in some powerful member states, could lead it to extend the boundaries of protection as well as of negotiation. Setting rules of origin or national composition to restrict the benefits of trade concessions to all or particular developing countries (e.g. ACP producers of bananas) or to extend the coverage of quotas (e.g. to include products of Japanese car companies' operations abroad in quotas for Japanese cars) could become more important risks for the trading system.

These actions are destructive of the principle of multilateralism. A more general risk is that, with a single trade policy-making body in Brussels and the greater communality of interest among the member states, the Community will become the third member of a cartel dominating the international trading system. In trade policy power can corrupt. That is the message of the US Super-301 'crowbar' or the strategic impediments initiative against Japan, which use access to the US market to force other countries to open their markets to US goods, services and direct investment and which the GATT has been powerless to prevent.[2] The SEM has given the Community power in the system and has also made it conscious of that power. Witness the demands for 'reciprocity' (from the developing as well as the developed countries) in return for continued access to EC markets, a clear abuse of the most-favourednation (mfn) principle. Unfortunately when one member of the triad flouts the letter or spirit of international trade law, the other members are likely to respond with an equal or greater violation.

The SEM, then, could change the international trading system in either direction. In some respects it will further a less discretionary, more rule-based system. But there is also the threat of regression to less-regulated, more power-based rivalry. Being the weakest members, the developing countries need the benefits of rules and multilateralism. Whether or not it furthers these may in the end be the most important long-term effect of 1992 on the developing countries.

Notes

1. The text was completed before the December 1990 ministerial meeting of the GATT.
2. 'Super-301' is a provision of the 1988 US Trade Act under which retaliation can be taken against any country considered to be trading unfairly. The 'Strategic Impediments Initiative' involved a negotiation and eventual agreement in 1990 between the United States and Japan in which the latter, threatened by restrictions on its exports to the US, agreed to undertake macroeconomic and sectoral policies designed to increase US exports to Japan.

2
Merchandise Trade

At present the structure of EC imports is more the outcome of a complex set of preferential and protective interventions in trade than of the free interplay of international competition. The 1992 programme to 'complete the internal market' will have major implications for these interventions and hence for the structure of EC imports, including those from the developing countries. Indeed, since both EC preferences and EC protectionism are often directed towards specific countries, 1992 will have particularly significant repercussions on these countries' exports.

First of all, there are the internal barriers which the 1992 programme is intended to eliminate. While imports from partner members within the EC tariff-free market have risen relative to those from outside, in order to protect their own producers member states have often counteracted the effects of the customs union by preserving, or erecting, barriers to intra-EC trade. The goal of the 1992 programme is, of course, a unified trading block in which these barriers will no longer inhibit the movement of goods, services, people and capital across the Community.

Secondly, EC participation in the world-wide spread of protectionism in agriculture, steel, textiles, chemicals, footwear, and, recently, consumer electronics has limited the role of free international competition. To the extent that this protection is based on instruments adopted by individual member states it is incompatible with the elimination of intra-EC border controls. Were 1992 to be associated with a rise in protectionism by the EC — the Fortress Europe bugbear — existing member state import restrictions could be replaced by much more stringent restrictions on access to the EC market as a whole.

Thirdly, the structure of EC imports has reflected a complex of preferential arrangements based on historical trading patterns. Once the ACP states and the EFTA countries with duty-free access to the EC for their manufactures, the beneficiaries of the Generalised System of Preferences with their tariff preferences, and the Mediterranean countries with a network of special arrangements are all excluded, the mfn tariffs apply to only seven countries (Australia, Canada, Japan, New Zealand, South Africa, Taiwan and the United States). Even then, trade is either closely managed with a host of discriminatory export restraints (Japan and Taiwan), or is largely agricultural and subject to the variable levies of the Common Agricultural Policy, or mineral and subject to none. The mfn tariffs of the EC are thus effectively tariffs on US exports (Wolf, 1988). Although — and partly because — it is changing with new concessions to Eastern European countries, the 'pyramid of preference' is going to outlive 1992.

The Eastern European countries have been until recently at the bottom of the hierarchy. Now their status is changing. Even those countries which are members of the GATT — Hungary, Poland, Romania and Czechoslovakia — have until now had their exports to the EC almost totally regulated through quotas so that mfn status has not allowed them to compete for market share. Recently the EC has eliminated quotas on a number of products from Hungary, Poland, Czechoslovakia and Bulgaria but the future of quotas on 'sensitive' items (including steel and textiles) remains clouded. These four countries have also been given GSP status. The Eastern European countries are thus step by step being given a special status — their own tier in the hierarchy of preference — and this implies the loss of tariff preferences for the exports of the non-ACP developing countries. In cases where certain developing countries are still subject to non-tariff barriers, steel, clothing, textiles and shoes, it could lead to a further layer of discrimination against their exports.

The situation with East Germany is different. Until re-unification, the GDR had free access to the Federal Republic's market, but in principle not to that of the other member states. With the elimination of trade barriers in 1993 within the EC, the GDR would have become, at least *de facto*, an EC member for trade purposes. Since political re-union with the Federal Republic in October 1990, it is, of course, now part of the Community.

Trade creation and diversion

The concept of a Single European Market is based on the idea that the Community needs to make a quantum leap in productivity and competitiveness if it is to compete effectively with the United States, Japan and the Newly Industrialising Countries (NICs). But it also means an improvement in competitiveness vis-à-vis developing country exporters as well. Other things being equal, this would mean a further redirection of trade away from traditional suppliers and towards intra-EC trade, analogous to the redirection that occurred after the initial elimination of internal tariffs. This is the trade diversion effect of 1992.[1]

As a basis for calculating the trade effects we have used here the results of the studies undertaken by the Commission and its consultants for the Cecchini Report. These did not consider the effects on the developing countries. Indeed, they did not treat the effects of the 1992 programme on the world beyond the Community's borders, except in the context of some estimates of total trade diversion from third countries, and of course the GDP impact within the EC itself. Since its publication, some writers (for example Neuberger, 1988) have argued that the Cecchini Report overestimates the effects on Community GDP. On the other hand, Baldwin (1989) has argued that the Commission studies do not take account of the medium-term investment effects and therefore underestimate the impact of the SEM on innovation and investment. He would almost double the Cecchini effects on EC GDP growth.

We have taken the Cecchini figures as a basis for estimating the trade barrier effects for the developing countries as a whole and, separately, for the ACP states. Details of the calculations are given in Appendix 1. The estimates are based on 1987 data. We have argued that it is likely that the trade effects may to some extent already have been achieved. The Commission's White Paper was published in June 1985. Given the lags in investment plans and implementations, it is unlikely that the prospects of a SEM could have had a major impact on EC trade flows before 1988. However, with the 1988 investment boom probably partly the outcome of the 1992 programme, the use of 1988 data might have led to biases in the estimates of the SEM effects.

Trade diversion is important for exports of manufactures, including refined mineral oils. As regards primary goods exports, the Community is generally (i) not itself a producer, or (ii) is a small producer and can only sell to third countries at the world market price, or (iii) manages internal production through the Common Agricultural Policy, where the internal price mechanism is divorced from the world market. In none of these cases will trade diversion operate.

However, demand for primary commodities does not respond as much to increases in income as does demand for manufactures. A number of econometric estimates of the elasticities of import demand for primary goods are available. On the basis of these, and the assumption that 1992 will boost EC GDP by 5%, we calculate that EC primary product imports from the developing countries will rise (at constant prices) by just over 2.9 bn ecu and manufactured imports by 4.4 bn ecu (see Table 2.1). Agricultural

Table 2.1
Trade creation and trade diversion in developing country and ACP exports to the EC[a]
(m. ecu).

	Income elast. of demand	*Trade creation, m. ecu*	
		ldcs	*ACP*
I.			
Food, beverages, tobacco	0.4	349	110
Agricultural raw materials	0.80	188	62
Ores and metals	2.16	383	132
Fuels	1.22	2,000	269
Manufacturing	1.3	24,434	315
Total		7,354	887
II.		*Trade diversion, m. ecu*	
		ldcs	*ACP*
Manufactures		4,651	450
III.			
Total: export change		2,703	437
as % of total exports to EC		2.7	2.5

Note

a. the method and elasticities used to estimate the trade effects are discussed in Appendix 1. The ACP grouping includes EC member state overseas territories.

goods that are subject to a CAP regime have been excluded on the grounds that increases in EC demand will be satisfied through Community production. In the case of the ACP states, trade creation in primary goods comes to just over 0.5 bn ecu.

The size of trade creation depends crucially on the income elasticity of demand for fuel imports, which is considerably higher than that for most primary goods. Indeed, 2 bn ecu — or 68% — of the 2.9 bn ecu export increase for primary products is made up of increased fuel exports. Primary goods excluding fuels show a 4.4% increase. However, the share of fuels in exports to the EC is not the only important compositional factor. The ACP states benefit from the weight of tropical beverages and several industrial raw materials in their exports to the EC, but relative to the developing countries as a whole the share of oil in their exports is low.

These estimates must be qualified in terms of uncertainties over elasticities. Lack of econometric evidence has forced us to use the same import elasticity for all suppliers, when in practice goods, including primary products, are often distinguishable by their country or region of origin. For example, exotic tropical fruit from Central America may well have a much higher elasticity than temperate fruit from the South American Cone.

Governments and entrepreneurs in most developing countries typically search for goods where they have some advantage through climate, topography, experience or labour costs, where market penetration in the developed countries is limited but where the potential, with appropriate marketing, is substantial, and where income elasticities are thought to be high — in short, 'niche' products. It might appear that our calculations of the trade creation effects of 1992 on primary products pay insufficient attention to such products as exotic fruits, prawns, flowers and ornamental plants. It is true that exports of these products to the EC have multiplied rapidly over recent years. But their increased popularity may be largely the result of the increased exposure of European consumers through foreign travel, through marketing campaigns and through increased numbers of 'exotic' restaurants. How much the once-and-for-all boost to incomes associated with 1992 will lead to increased demand is questionable.

Moreover, even if the income elasticities of demand for such goods are high, most of them still account for very small shares of developing countries' exports. For example, the major imported exotic fruits — mangoes (and mangosteens and guavas which come under the same NIMEXE heading), fresh pineapples and papayas — account for less than 6% of developing countries' exports of fruit and nuts to the EC. Adding even more esoteric fruits would not increase the share significantly. Trade in other formerly 'niche' products, such as flowers and shrimps, has reached major significance for certain countries. To some extent that trade will be discussed in Chapter 7 in the context of the impact of 1992 on particular countries. In these cases, however, the extent to which income elasticities are still particularly high, if indeed they ever were, can only be determined by extensive econometric analysis.

On the other side it could be argued that our trade creation estimates ignore the opportunities for 'second-order' trade diversion in primary products. This may take place where primary product imports can be replaced by substitutes produced more competitively within the SEM. In some cases these may be 'real' substitutes. Economies of scale in energy production may reduce the price of EC-produced cut flowers and divert imports to EC growers. In other cases 1992-related cost reductions may make 'artificial' substitutes more competitive, e.g. synthetic rubber or man-made fibres. Thirdly, they ignore 'international multiplier' effects; higher primary product exports to the EC will stimulate GDP growth in the developing countries, thus leading to increased trade between the developing countries themselves and with the non-EC developed countries. Fourthly, the 1992 programme may have a particular impact on the integration of Portugal and Spain into the Community, with these countries, under the impetus of 1992, passing through the stages of free trade area, customs union and common market much more rapidly than the older EC members (Langhammer, 1989). Since they are in general in more competition with the exports of the developing countries than the rest of the EC, the extent of trade diversion will be increased. Finally, technological innovation will be stimulated by the 1992 programme (Langhammer, 1989). Besides accelerating investment in labour-saving techniques which could reduce the cost advantage of the manufactured exports of the developing countries (such as clothing), the SEM could also stimulate investment in resource-saving techniques, which would reduce the demand for fuels and other minerals.

On balance, the higher-order effects are likely to be small relative to the direct trade creation impact. Also they will tend to work in both directions. For example, the international multiplier effects will amplify those of direct trade creation, while trade diversion will offset some of the trade creation effects. In any event, quantifying these effects would be much more uncertain than quantifying the direct effects. For these reasons, it seems reasonable to assume that the net result of all the higher-order effects — and any abnormally high income elasticities — taken together is negligible.

On the basis of our analysis it appears that the developing countries most likely to gain from the trade creation effect are those producing fish, fruit and nuts (including bananas), tropical beverages, tobacco, wood, metallic ores, textiles and, above all, mineral oils. The consequences for a selected group of countries will be analysed in Chapter 7.

For manufactures import elasticities are estimated to be generally higher than for primary goods. Nevertheless for developing countries' manufactured exports as a whole trade diversion is estimated as somewhat greater than trade creation. The sector contributing most to both creation and diversion is machinery and transport equipment (see Appendix 1 for details of the sectoral effects). This sector has a high import elasticity. Its high 'diversion elasticity' stems largely from the potential for economies of scale and other available gains from industrial restructuring within the EC. The same factors explain the major diversion effect in chemicals. Only in textile yarns and 'other' manufactures is there a clear preponderance of trade creation over trade diversion.

Because of the high degree to which the trade is regulated, exports of textiles and, more important to these countries, clothing will be affected primarily by changes in the EC Multifibre Arrangement (MFA) rather than through trade creation or diversion. A liberalisation of the MFA would allow both these effects to occur in those goods which are currently covered. Little trade diversion in MFA goods would take place if the present regime is extended, or an equally restrictive regime put in place, since reductions in the costs of EC production can largely be matched by reductions in the profit margins (or economic rent receipts) of the developing country exporters, particularly those in the NICs. The estimates of trade creation and diversion have been retained in our tables because of the real chance of a significant relaxation in the EC MFA owing to the Uruguay Round negotiations currently nearing completion, together with the 1992 effect of eliminating member state quotas, discussed in Chapter 3.

Terms of trade effects

The SEM is expected to reduce production and distribution costs, increase competition among EC producers and lead to rationalisation of plant, economies of scale and other advances in efficiency. The Commission (1988a) estimates the reductions in average costs at 3% in agriculture and 4-6% in manufactures. These reductions have positive implications for the prices of developing country imports. Moreover, reductions in EC export prices might in some cases bring down the prices charged on world markets by non-EC suppliers, by forcing them to engage in restructuring to capture economies of scale, or to reduce X-inefficiencies[2] in production or producer rents.

However, the link between lower EC costs and import prices depends on a large number of factors, some of which are themselves enmeshed in the 1992 process. For example, the degree of industrial concentration is important in determining the extent to which cost reductions are passed on to final consumers. Also important is the degree to which EC producers can price-discriminate between the internal and the world markets. To the extent that 1992 leads to restructuring, it may increase the concentration of EC industry and thus oligopolistic power. Moreover, it might be argued that, since 1992 is all about maintaining the EC's competitive position in the world economy, it will not offer a significantly cheaper source of imports. At best it will meet the competition from Japan, the NICs and the newly emerging industrialised nations of South-East Asia and so on.

In any event, these terms of trade gains are unlikely to occur in those primary goods where the Community is a relatively small exporter and has little impact on world prices. In the case of CAP goods — the only primary goods in which the EC is a major exporter — it tends to 'dump' large quantities on the world market and thus depress the world price. But changes in productivity in the production of CAP goods are determined in the main by a combination of technological change and structural subsidies on the supply side and the administered price system with its panoply of incentives to produce and penalties for over-production on the other. The impact of the SEM on productivity in the CAP sector will be insignificant unless there is a major shift to a market system, which seems improbable.

As a result of these considerations, reduced prices have only been included in this study in the case of manufactured exports to the developing countries, and then only the reductions associated with the direct effects of the SEM on costs. In other words, the efficiency gains from abolishing internal borders, member state public procurement restrictions and national standards have been included, while those from the restructuring of production, in particular economies of scale, reductions in X-inefficiency and monopoly rents have not.[3] The former set of export price reductions on manufactures as calculated by the Commission were then weighted by developing countries' imports from the EC to arrive at an average reduction in import prices of 1.6%.

There will also be a terms of trade effect from increased prices as higher EC demand pushes up world prices for goods for which there is an efficient international market. This gain will depend on the share of the EC in developing countries' exports, the income elasticity of demand and the price elasticities of import demand and export supply. Details of the calculations are given in Appendix 1. Fuels are not included since supply from each oil-producing country is primarily determined by the OPEC quota system, which means that output is no longer price-sensitive even though there may be considerable 'cheating' on the quotas themselves.

As shown in Table 2.2, the terms of trade effects are quite small, particularly when set against average year-to-year fluctuations in commodity prices. At the same time, they are more speculative than the demand effects from 1992-induced increases in output and incomes in the Community. As noted earlier, it could be argued that the prospect of the SEM has been a major contributor to the recent strength of investment and GDP growth in the Community and, through international multiplier effects, throughout the industrialised world, and that that strength has generated the surge in mineral prices since 1987. Between 1986 and 1989 the World Bank's index of mineral and metal prices rose 41% in real terms (i.e. deflated by an index of manufactured export prices). Over the same period world GDP rose by 11%. Given that there is likely to be some overshooting as stocks of minerals are built up after having being run down during the previous recession, this is not inconsistent with the assumed income elasticity of demand for minerals of 2.16. Indeed, since their peak in the second quarter of 1989 mineral prices fell by 11% in the following twelve months despite continued, though slower, growth in world GDP.

Table 2.2
Terms of trade effects of reduced EC export prices and increased EC demand for developing countries' exports[a]

I.

Reduction in import values from lower EC export prices

	Terms of trade gain % on imports from EC		*Terms of trade gain m. ecu*	
	ldcs	*ACP*	*ldcs*	*ACP*
Manufactures	1.6	1.6	733	54

II.

Rise in export values from increase in primary product prices

	EC share in world imports %	*Incr. world demand %*	*Incr. world price %*	*Terms of Trade gain ldcs m. ecu*	*ACP*
Food and tobacco	41.0	1.1	0.9	380	88
Agric. raw materials	27.3	1.1	1.1	182	21
Ores and metals	34.4	3.7	3.4	695	119
Total				1,256	228

III.

Total: terms of trade effects	1,989	282
As % of total exports to EC	2.0	1.6

Note

a. the method and elasticities used to estimate the terms of trade effects are discussed in Appendix 1. The ACP group includes overseas territories.

Combining the trade effects, the most obvious point to be drawn from these estimates is that the 'locomotive' effect, working through increased EC demand for its merchandise imports, is not going to be very great. For the developing countries as a group, trade diversion almost offsets trade creation, and the gains from lower EC export prices, uncertain as they are, are likely to be useful but modest.

Secondly, it is unlikely that any of these gains will be noticed. They will be spread over a number of years and, to a large extent, may have already taken place. They will do little to assuage the resentment of developing countries who find their access to the EC market blocked because of new health or phyto-sanitary standards or who are faced with damaging competition for hitherto privileged exports.

Thirdly, the effective accession of further European countries to the SEM is, from the point of view of general trade effects, of no great moment as regards the developing countries. In particular, it is not very important for these countries as a group whether or not the EFTA countries become part of the SEM; estimates of both trade creation and diversion would increase and would be largely offsetting. There might be specific gains or losses for individual countries, but they are not obvious at this stage.

East Germany is now part of the Community though not yet fully integrated in terms of the Common Agricultural Policy or the common customs union. Clearly its rapid growth will have both trade creation and diversion implications for the developing countries. Trade creation will be important for those commodities which have hitherto had a restricted market, not only because of low disposable income but also because access has been restricted in order to economise on foreign exchange. Bananas and coffee fall into this category. As regards diversion, Eastern Germany will benefit from its proximity to the rest of the EC market and the customs union effects of its new membership, as well as 1992-specific factors. It will be more competitive with the developing countries in a number of critical sectors — textiles and clothing, shoes and vegetables — and with inward investment and the restructuring of existing firms it could become competitive with the NICs in electronic components and certain consumer electronics. However, the problems facing the economic rehabilitation of Eastern Germany are immense. At this stage one can only take note of the threats which might become real at some stage in the future.

Fourthly, as a result of these general trade effects, it does not appear that the poorer of the developing countries, of which we can take the ACP states as a representative sample, will gain relatively more than the better-off. Since they export a lower proportion of manufactures, they will suffer less trade diversion than the better-off countries. However, this relative gain is offset by the adverse composition of their primary exports to the EC. Chapter 7 goes into further detail on this point in relation to individual countries.

Our terms of trade exercise has ignored two factors — international GDP linkages and exchange-rate effects. We have assumed that, despite the substantial growth in EC GDP which the SEM has generated and will continue to generate, this growth will not spread though the international multiplier to other developed countries. The reason is simply that, as well as a demand stimulus, 1992 will give a supply stimulus. Indeed, trade diversion vis-à-vis the outside world as a whole could well exceed trade creation, in which case there would be negative linkage effects. In the run-up to 1992 it is likely that the demand effects of higher investment expenditure have dominated the supply effects and thus contributed to the strong growth in the OECD area since 1987. As those investments begin to bear fruit and productivity in the EC picks up, the opposite will happen. Since we are looking at the overall effects of 1992 and are not concerned with their distribution over time, it is preferable therefore to assume no net impact on GDP growth in the rest of the developed world.

The same sort of argument applies to our implicit assumption that 1992 will not of itself lead to sustained changes in exchange rates. Certainly the balance of trade of the Community will eventually benefit from the SEM, but that extra margin of manoeuvre can be taken either as increased foreign-exchange reserves and/or investment, lower inflation and rising EC exchange rates, or, alternatively, higher growth, lower unemployment and even falling exchange rates, depending on what macroeconomic policies are followed in the Community (see Catinat et al., 1988). Our assumption is an intermediate one — that the gains from the SEM are translated into a once-and-for-all increase in GDP at roughly constant real exchange rates. Certainly as in the case of international multiplier effects, the dynamics may imply generally weaker EC exchange rates in the early years, and thus a negative impact on imports from the rest of the world, followed by a strengthening as productivity gains take hold, with EC exchange rates generally above their starting levels and positive import effects.

Notes

1. The term 'trade diversion' is used to refer to the total displacement of imports from suppliers outside the EC to those within, regardless of whether that displacement is directly occasioned by the elimination of intra-EC barriers (trade diversion in the strict trade theory sense) or other 1992-related cost reductions in the EC. Also the term 'trade creation' is used for the increase in extra-EC imports stimulated by the rise in EC output or incomes. Strictly these usages are at variance with the traditional trade-theory meanings of extra-customs union trade diverted or intra-union trade stimulated solely by the price effects of removing barriers, but they have now become general usage in the 1992 context.
2. Including overmanning, excess inventories, excess overhead costs and other reducible costs other than those associated with a sub-optimal structure of production.
3. For the taxonomy of the microeconomic effects of the SEM and the quantitative back-up to the Cecchini Report, see Cawley and Davenport, 1988.

3
Trade Effects in Specific Sectors and Community Trade Policy

Textiles and clothing

The quantitative restraints on textiles and clothing imports must be separated into those established under the umbrella of the Multifibre Arrangement and the hotchpotch of other QRs which have been set up independently by the member states, in some cases before they joined the Community. In both cases they depend to varying degrees on the use of Article 115 of the Treaty of Rome which allows member states to suspend free circulation of goods within the Community where outside exporters are circumventing, or threatening to circumvent, member state quotas by trans-shipping goods through another member state. Article 115 will no longer be available once internal border controls are removed.

Traditionally the production of clothing and textiles has been the entrée into manufacturing for developing countries. However, this route has long been made more difficult by the Multifibre Arrangement, through which the EC, the United States and most other developed countries regulate imports from developing countries to protect their domestic industries. The present MFA (MFA IV) is particularly complex in that the EC quotas are generally sub-divided into member state shares or 'subquotas'. These cover the imports of up to 93 products from each of 17 developing countries (including China and Taiwan which were not MFA signatories) and 5 centrally planned economies, though in earlier EC MFAs several additional developing countries were included.[1] Thus all EC imports of clothing and textiles from developing countries have in effect been subject to quantitative controls. Some have faced actual controls and others have been subject to explicit threats embodied in the progressive tightening of controls, the spread of agreements, the restraints on ACP and other 'exempted' countries, and the 'basket exit' procedure, through which new quotas can be imposed on products from an exporting country not previously restricted when its share in EC imports expands. Although the MFA text does not limit its application to developing countries, and the criterion for intervention is 'market disruption', only these countries have been subjected to it, and the criterion has come to imply 'low-cost' producers (Raffaelli, 1990).

The Fourth MFA (1986-91) does not seem to have brought as significant a tightening of import controls as the previous ones. The number of countries with formal agreements had reached 23 by 1980. Although there were some changes during MFA III, the number remained about the same until it fell in MFA IV to 19, with no agreements imposed on Bangladesh, Colombia, Mexico and Uruguay, although 'consultation' agreements allow the re-introduction of restraints (*ibid.*). The EC also introduced, for the first time, provisions for outward-processing, with re-imports given extra quotas (explicitly, or through increased quotas for the goods affected).

The future of the MFA is closely bound up with the Uruguay Round of trade negotiations, where the Textiles Negotiating Group is due to propose ways of bringing these products back under the GATT. Whatever the outcome of the negotiations, the process of reintegration of these sectors into the GATT will take some years. In any event, it cannot be achieved before the current MFA expires in mid-1991. Meanwhile the SEM programme will have its own, if more limited, impact on the EC MFA and so on imports of clothing and textiles.

The present division of EC quotas into member state shares depends on the existence of intra-EC border controls. Article 115 is invoked to prevent the 'deflection' of textiles and clothing more often than for all other commodities combined. Under the next MFA (though it may be called something else to emphasise its transitional nature), EC quotas are likely to be retained while member state shares (or subquotas) are abolished. Commission officials have repeatedly said that Article 115 is incompatible with the internal market, and even more specifically that:

> The allocation among individual Member States of the export quotas ... in the framework of the Multifibre Arrangement and the insulation of Member State markets from each other are clearly incompatible with the goals of the internal market. (Frisch, 1988)

However, the possibility is now being mentioned that subquotas could still be assigned to individual countries, but without any mechanism to control intra-EC movements. Many third-country goods which come in under different national restrictions are not subject to Article 115 now, including MFA-type controls on Turkey. The costs of trans-shipping (and possibly informal pressures) could be a sufficient substitute. It is difficult to know whether this would satisfy industrial pressures. But other potential problems in intra-EC movement of imported products (cars, horticultural goods, bananas) suggest that some form of monitoring may occur, if not at the EC level then by those member states where the sectoral problems are most acute.

It seems plausible to assume that Article 115 is now used principally for products where there is most opportunity to trans-ship, or most potential gain. If so, it is not valid to assume that because in the past there have been relatively few problems for goods not covered this will also be true for goods which have been covered. It also seems increasingly unlikely that the problem can be resolved entirely at the expense of MFA exporters. Reducing EC quotas to a level low enough to be equivalent to the most restrictive national subquotas would not only be formally contrary to the MFA, but would also go against all the indications in the GATT textile negotiations that the MFA is regarded as a fading instrument.

Whether these arguments prevail for EC quotas and, if they do, how serious any *de facto* internal restraints will be, may depend not only on industrial bargaining strength, but also in part on how large the effects of relaxing MFA constraints are expected to be. In the long run, if countries are convinced that the MFA is being phased out the incentive for new investment in new countries may strongly alter the pattern of trade. Low labour cost suppliers in clothing would be favoured and this would have a strong impact on EC producers.

In the short run, abolishing member state subquotas without adjustment to the EC quotas, and with no new recourse to other forms of safeguard, would mean some liberalisation, since each exporting country could exploit its EC quotas more intensively. At present certain subquotas remain underutilised, but there are restrictions on the extent to which an unused portion can be transferred to a member whose quota is filled. However, not all the exporting countries are now constrained by quota for all MFA products. In some cases an EC quota might be introduced where

Table 3.1
Potential growth in MFA products following the elimination of member state subquotas
(tonnes and %, based on 1988 imports)

	1988 '000 tonnes	*initial util.*	*Final util.*[a]	*Export growth*[a]	*Final util.*[b]	*Export growth*[b]
Peru	9	81.7	84.6	3.5	88.9	8.8
Brazil	62	73.8	76.8	4.3	77.7	5.6
Argentina	9	31.8	32.4	1.9	33.2	4.4
Pakistan	86	90.2	91.7	1.7	91.9	1.9
India	73	82.5	85.7	3.9	86.2	4.5
Sri Lanka	4	85.8	90.2	5.1	96.0	11.2
Thailand	50	65.3	67.7	3.7	70.5	8.0
Indonesia	8	86.8	89.2	2.8	90.6	4.4
Malaysia	20	51.3	51.9	1.2	52.7	2.7
Singapore	9	57.9	59.3	2.4	61.3	5.9
Philippines	8	72.3	74.6	3.2	77.3	6.9
S.Korea	102	81.0	83.4	3.0	84.2	4.0
Taiwan	63	72.2	74.6	3.3	77.1	6.8
Hong Kong	87	74.5	76.4	2.6	78.4	5.2
Macao	22	75.2	77.9	3.6	79.7	6.0
Yugoslavia	20	73.0	76.7	5.1	81.9	12.1
China	71	74.4	76.5	2.8	78.7	5.8
Averages		76.1	78.4	3.0	80.0	5.1

Notes

a. assumes that exports to member states with binding subquotas in 1988 would expand by up to 10%, subject to overall EC quotas. See text for further assumptions.

b. assumes that exports to member states with binding subquotas in 1988 would expand by up to 25%, subject to overall EC quotas.

one did not exist in the past. Moreover, if the Commission were administering the quotas rather than the member states, they might be more strictly enforced than at present.

In MFA IV a new mechanism was introduced which makes for the automatic transfer of quotas that have not been fully used in some member states to other member states under certain conditions. Despite this, there is a considerable mismatch between the individual member state subquotas and demand, so that quotas frequently remain substantially underutilised in certain member states while they are exhausted in others. Quota utilisation is imperfect as a measure of restrictiveness. As subquotas approach full utilisation the probability of a shipment being denied an import licence will rise, but there are delays in the recording of imports and different member states show different degrees of strictness. As a result quotas are often overfilled by a considerable margin. Also a fully-utilised quota does not imply that it has been binding; imports might have been at just the same level without the quota.[2]

We carried out an exercise to estimate the effects of abolishing member state shares while holding EC quotas at their existing (1987) levels. In those cases where a supplier was given a quota only for a limited number of member states, it was assumed that an EC quota was set equal to the sum of any existing member state quotas and, otherwise, the level of imports in 1987.

Table 3.1 shows what would have happened if member state subquotas had been eliminated in 1988, under two alternative assumptions as to the amount that imports in the constrained member state markets would have expanded. The second column of the table shows the initial level of exporter country utilisation of its total EC quotas, while the third column shows the hypothetical utilisation, had the imports in those member states where the subquota was binding expanded by 10% or by whatever smaller percentage would be allowed by the underutilisation of the EC global quotas.[3] The final two columns show what would have happened, under the same assumptions, if the maximum volume of member state imports were to rise by 25%.

The choice of 10% for the increase in the sales of quota-restricted imports in alternative (a) is clearly arbitrary. It was suggested by a comparison of the growth rates in volume of imports of products subject to binding and to non-binding EC quotas. Between 1981 and 1987 the volume of the former rose by 37% while that of the latter rose by 48%. However, member state subquotas are more restrictive in their effect than EC quotas as a whole appear to be, since the degree of utilisation of the latter averages out the differences in utilisation between individual member states. Thus the exercise was repeated using an assumption in alternative (b) of up to 25% growth where binding member state subquotas are eliminated.

The calculations show overall exports of MFA goods from the developing countries subject to MFA quotas rising by 3% using assumption (a) and 5.1% under assumption (b). In the latter case the growth of imports will be limited by the overall EC quotas more often than in the former and thus the aggregate rise in imports is less than twice that derived under assumption (a). The exporting countries most likely to benefit from the elimination of member state shares are Sri Lanka, Yugoslavia, Brazil and, possibly, Peru, Thailand and the Philippines. For Sri Lanka and Thailand textiles and clothing are particularly important components of total merchandise exports, constituting 8% (1984) and 6% (1985) respectively. The total increase of exports at 1987 prices would have been between 328 and 550 m. ecu, almost 3-5% of total developing country exports of textiles and clothing to the EC in 1988. If the Asian NICs are excluded, the upper limit of the range rises to 6%.

These computations are totally mechanical. They ignore the fact that in any particular product market, the unconstrained suppliers, as well as the member state domestic industry, are able to enjoy higher sales than they would in the absence of constraints on other suppliers. It is difficult to judge the significance of this, but given that member state shares have evolved so as to limit the overall level of import penetration by targeting the most competitive suppliers of each product, the offsetting reduction in other developing country supplies is likely to be fairly minor. This effect will be concentrated on the least restricted suppliers, which tend to have the greater gains in the calculations.

The ACP countries have only a small share in EC imports of textiles and clothing. The major ACP exporter, Mauritius, had 0.2% of world trade in clothing in 1980 and 0.5% in 1986 (Cable, 1990). No ACP country had as much as 1% of EC imports of clothing in 1982 (GATT, 1984, Appendix). Nor are textiles and clothing major exports for the ACP countries, except for Mauritius where they constitute over a third.

The question of whether the ACP countries have gained from the lack of formal MFA controls and tariff preferences is debatable. The potential to gain was there. The Mediterranean suppliers have increased exports much more rapidly than MFA-controlled countries since 1973 (GATT, 1984, p.106), as have internal suppliers like Italy. And the data on quota utilisation strongly suggest that quotas have been binding, thus giving opportunities for alternative suppliers. The ACP countries have not achieved these gains. Their share of EC imports rose from 0.5% in 1981 to 0.8% in 1987 (Erzan et al., 1990, p.17). This was better than the unchanged share of MFA-affected countries, but poorer than either the average for unaffected countries or the gain in share from 3.4% to 6% of the Caribbean Basin Initiative (CBI) countries in the US market. Jamaica has gained more from CBI access to the United States than from Lomé access to the Community. The one counter example is Mauritius, which has remained successful in spite of the controls placed on it (Cable, 1990, p.38). It probably benefits principally from the freedom from tariffs, not from controls, and its success is in a limited range of high value clothing, intensive in skilled labour. It has also had a history of access to foreign investment. Its characteristics and its success are not typical.

It is possible to identify product lines in which several ACP countries have increased their exports to the Community (although Mauritius is the principal supplier found for textiles and clothing products), and where investors suggest that the preferences influenced their decisions (Stevens and Weston, 1984; McQueen and Stevens, 1989). The presence of other products, where only the tariff preference could have been operating, suggests that the MFA was not crucial. Agarwal et al. (1985) conclude that the principal obstacles to ACP exports lie on the supply side, not in protection. Thus the marginal erosion of ACP preferences from eliminating member state shares in the Community MFA will have little impact. At most, Mauritius and Zimbabwe will have to compete more aggressively in those Community markets where lower-cost producers have hitherto been restricted.

More generally, when member state shares are removed, textile and clothing suppliers, including domestic suppliers, will be in competition for the markets which are at present restricted. This means that there will probably be some offset to the volume increase through a decline in prices, which will depend on the elasticity of demand and own and cross-price elasticities of supply. This reinforces the conclusion that the estimates of volume effects are likely to be on the high side.

But increased competition has further implications. Already certain suppliers, particularly those in South Korea and Hong Kong, are setting up factories elsewhere, to some extent to take advantage of underutilised quotas, but in large part because their own rising labour costs are making domestic production less competitive. Among the suppliers identified above as most likely to benefit, Peru and Brazil may suffer relative labour cost problems.

The impact of the phased elimination of the MFA will be much greater than that of simply dropping member state subquotas while maintaining the overall EC quota. In the short term, the details of the transitional regime will be of great importance to developing country producers. In the longer term, the details of the 'necessary strengthening of GATT rules and disciplines', so insisted upon by the Community, will be crucial in determining their effective access to the EC market. It is not yet possible to predict the outcome of the GATT negotiating group's deliberations. We are concerned here only with the 1992 effect, namely the elimination of member state subquotas.

The calculations do point to a relatively minor overall impact. For a number of exporting countries the elimination of member state subquotas could yield a significant gain, roughly equivalent to the average volume growth experienced over the 1980s. For most suppliers and for the developing countries as a whole the gains are positive but are likely to be relatively modest and rather less than the annual volume increases recorded over recent years, averaging over the period 1981-7 5.4% for products under binding quotas and 6.7% for products under non-binding quotas (Erzan et al., 1990). Of course, this is a reason for the Community to adopt a determined stance against industry pressures, particularly from the southern member states, who are arguing against any liberalisation.

Horticultural and fishery products

From the very outset of the European Economic Community, certain member states, in particular France, insisted on 'grandfathering' (that is, prolonging, despite an inconsistency with the Treaty of Rome) their quantitative restrictions (QRs) on horticultural produce and fish. These QRs were allowed to continue 'temporarily', even though they implied restrictions on the free circulation of goods within the Community. A new set of transitional restrictions were established after the accession of Spain and Portugal. Now both sets of restrictions are due to be eliminated, the earlier ones probably by 1993 (though there is no commitment on the part of the member states to accept the Commission proposals) and those protecting Spain and Portugal by 1996 (though this date might well be advanced). Neither set is, strictly speaking, a 1992 effect — the 'grandfathered' QRs have been long due for removal because they are inconsistent with the CAP — though the 1992 programme may have brought forward their demise. The Commission had promised to table some proposals by 1 July 1989 on how the QRs might be phased out, but has so far failed to do so.

The removal of the QRs will have implications for third countries but it is difficult to determine how important these will be — partly because it is hard to identify all the QRs currently being enforced. The Commission has provided a list in its proposal to modify Annex I of Regulation 288/82 (COM(90) 194 final) on common arrangements on the import of goods subject to national quantitative restriction. Inclusion on the list does not mean the restriction is being enforced. Nor does the list purport to include all the restrictions in force, though it does probably include the most important ones. It is also clear from inspecting the trade data on the detailed headings to which these QRs apply that in many cases they are being applied selectively, i.e. imports from certain countries are restricted while those from others are not. Indeed, certain of the QRs were originally intended to protect domestic producers in the member state, and others to protect producers in certain exporting countries which the member state wanted to safeguard from competition.

Recourse to Article 115 for agricultural goods has been limited. Other than bananas (which are treated here separately) the only cases since 1979 concern potatoes (from Spain to France in 1983 and 1984 and from Cyprus to Ireland in 1985), tomatoes (from Spain to France in 1982, 1983 and 1984 and from Spain to Benelux from 1981 to 1984) and honey (from Mexico to France in 1981 and 1985, from Hungary and China to France in 1985 and from Hungary to Italy in 1982 and 1983). The reason why Article 115 has not been used more often may be because most exporters are aware of the restrictions and do not consider the extra costs of trans-shipping through another member state worthwhile, particularly in the case of perishable goods. Most of the goods are only excluded for certain seasons of the year and the suppliers may consider that accepting the QRs is more politic than creating a stir and perhaps having their access further restricted.

However, it is unlikely that these QRs can be sustained beyond 1992. Apart from those cited in the Acts of Accession of Spain and Portugal, they would be difficult to defend against a legal challenge (even now they are legally questionable), and they would lack the sanction of Article 115. Moreover, the exporting countries will probably be less prepared to enter informal voluntary restraint arrangements with individual member states where the latter lack the sanction of imposing even tougher restraints.

The only way to assess the significance of these QRs to the producing countries is to go through them one by one, looking at the value of imports by the non-restrictive member states and, on that basis, judge whose exports to the restrictive state are being restricted and by how much.[4] Many of the QRs apply to products where imports among the non-restrictive member states are small, in some cases, minute. France restricts imports of tomatoes, lettuce, endives and other salad vegetables during the EC growing season even though Community preference under the CAP (here the reference price system) means that imports are minimal (in each case less than 1 m. ecu in 1987). Not content, like most member states, to restrict imports of potatoes in their traditional format, Germany restricts their import as frozen, frozen homogenised (sic), preserved as flour, meal or flakes, and preserved 'other, other'. Presumably these gestures are important to its farm lobby.

Some QRs are apparently redundant. The Community allows sardines only from Morocco, since only Morocco produces canned 'sardinus pilchardus'; sardines from other countries come in under other generic names. It does not then seem necessary for France to have a QR on canned sardines from which Morocco is exempted.

Table 3.2 lists the most significant identifiable QRs. Countries are identified as 'restricted' if their exports to the member state(s) in question are 15% or more below that 'predicted', where predicted imports are given by taking the value of imports to the non-restrictive member states and assuming that the restrictive states would have imported a value proportional to their share in total Community expenditure on food in 1987. Clearly the criterion is extremely simple and takes limited account of different tastes in the member states (simply allowing a 15% margin) or, since the calculations are done in value terms, the fact that prices might be higher where imports are restricted.

A negative sign in Table 3.2 means that that exporting country is exempted from the restriction, and in profiting from a special access

Table 3.2
Estimates of effects of agricultural and fishery QRs on exporting countries[a]
('000 ecu and %)

Product/ Exporter[b]	*Restricted Markets*	*Imports, restricted markets* *Actual*	*Predicted* '000 ecu	*Diff.*	*Shortfall* %
Honey					
Mexico	France	347	4,955	4,607	93.0
Argentina	France	584	4,010	3,426	85.4
Tomatoes					
Morocco	BLEU/Greece	5,021	5,438	4,936	90.8
Beans					
Egypt	France	503	1,850	1,347	72.7
Kenya	France	8,421	1,628	-6,793	-417.1
Kenya	Greece	0	236	236	100.0
Table grapes (not Emperor)					
Chile	BLEU/France/Greece	2,399	20,121	17,722	88.1
Table grapes (1/11 -14/7)					
Cyprus	BLEU/France/Greece	0	2,797	2,797	100.0
Melons					
Brazil	France/Greece	4	1,497	1,493	99.7
Israel	France/Greece	393	1,626	1,233	75.8
Pineapples					
Côte d'Ivoire	France	46,021	10,095	-35,925	-355.9
Kenya	France	160	1,879	1,719	91.5
Costa Rica	France	3	2,651	2,648	99.9
Tuna, Skipjack					
Mauritius	France	250	2,283	2,033	89.0
Thailand	France	2	14,029	14,027	100.0
Fiji	France	0	3,053	3,053	100.0
Black Skipjack					
Thailand	France	0	362	362	100.0
Orange juice					
Morocco	France	12,507	2,622	-9,885	-377.0
Morocco	Italy	0	2,908	2,908	100.0
Cuba	France/Italy	0	2,057	2,057	100.0
Brazil	France/Italy	9,881	272,988	263,107	96.4
Israel	France/Italy	8,674	31,868	23,194	72.8
Total			300,302		

Notes
a. headings where Community imported at least 10 m. ecu worth in 1988, excluding QRs of Spain and Portugal.
b. country exported at least 2.5 m. ecu worth to the Community in 1987, and imports by the restricting country were 'significantly' below what might be predicted. See text.

Sources: COM(90) 194 final, 30 April 1990. Eurostat, External Trade of the Community, 1987.

to the French market, exports more than would be predicted on the basis of the 'control' countries' imports. From the list of products in the table it is clear that the French QRs are primarily designed to protect the interests of ex-French colonies in Africa, though the interests of Guadeloupe in the case of melons and of French beekeepers are also apparent. Nevertheless, it seems almost by chance that Kenya is treated on a par with Senegal as far as beans are concerned but Egypt not on a par with Morocco. The random nature of bilaterally regulated trade is emphasised by the fate of Kenya pineapples, which do not get favourable treatment. BLEU (the Belgo-Luxembourg Economic Union), Greek and Italian QRs tend to be applied more comprehensively. They are apparently designed to protect producers in these member states. The BLEU QRs are listed as Benelux QRs but a look at the data suggests that they are not enforced on imports into the Netherlands (which implies that Belgium finds that they are worth imposing despite opportunities for evasion through trans-shipment through the Netherlands).

The results are certainly not meant to be definitive and should not be taken individually. But as a whole they are suggestive of the likely significance of QRs as a whole. In many cases, particularly those of Italy and Greece, they are clearly effective, since imports are (or are close to) zero, though of course the estimate of the value of exports lost is still based on over-simplified assumptions.

The sum of the estimates of the annual shortfall (at 1988 prices) in exports due to the QRs cited in Table 3.2 comes to 300 m. ecu. This excludes the impact of a number of QRs on products where imports are individually minor (i.e. under 10 m. ecu for all developing countries combined). It also excludes the widespread QRs on seasonal potatoes, where imports are not minor but the unrestricted markets are so thin as not to yield a plausible 'anti-monde'. Total imports of potatoes from the developing countries amounted to 83 m. ecu in 1987; at least as much again was probably prevented by QRs. The countries most affected by this restriction are Morocco (although it is excepted from the French QR), Cyprus and Egypt, though if there were a free market in new potatoes in the Community a number of other countries might try for some market share. Table 3.2 also excludes the effects of the cited QRs on smaller exporters, which are generally negative but in some cases positive for French ex-colonies or overseas territories. Overall it seems appropriate to estimate the total loss in revenue to the developing countries from the national QRs at 350 m. ecu.

Quantitative restrictions on manufactures

As with QRs in the agricultural sector, there is no authoritative list of member state QRs on manufactures, although for the surveillance or suspension of intra-EC imports under Article 115 QRs have had to be approved by the Commission. A list was published by the Commission (*Official Journal*, 9 February 1985) of national QRs that had been notified. However, apart from being very out-of-date, there is no way of determining which of them were binding at that time or binding when they were notified. Clearly member states may wish to keep QRs on the books so that they are available should there be demands for import limitation, though in a number of cases some of the listed QRs have formally been rescinded. The UK Government claims to have revoked all QRs other than those on footwear, leather gloves, ceramics, hats, television sets and matches imports from various Eastern European countries and China and, as a curiosum, ceramics from Vietnam.

The Commission's list does not include Voluntary Export Restraints. Many of the officially recognised Voluntary Restraint Agreements affecting the developing countries are now on a Community basis and will not be directly affected by the elimination of recourse to Article 115. These include VRAs on steel from Brazil, South Korea and Venezuela.[5]

One of the advantages of VRAs is that they are not subject to legislative scrutiny or even the requirement of publication. If member state VRAs are now effective without recourse to Article 115, either because the gains from trans-shipment through another member state are not commensurate with the extra costs, or simply because the exporting country would prefer to maintain its existing market (and possibly enjoy quota rents) rather than risk further restrictions on access in that or other exports, then they may survive the opening up of borders.[6]

Certain VRAs may not even be known to the member state governments. For example, it has become clear that Taiwan continues to restrict its footwear exports to the UK by agreement with the British Footwear Manufacturers Association, while the government believed the VRA to have expired when agreement was not formally reached in 1986. In this case the Taiwanese admit that they cannot prevent 'deflection' from other member states, but, then, if there are similar agreements with most members, deflection may not be a problem.

Applications for the suspension of free circulation under Article 115 provide some guide to those officially-recognised quantitative import controls which are currently binding. Table 3.3 lists applications for Article 115 protection in 1988 and the first seven months of 1989 which were directed at developing countries' exports. It shows that over this period, apart from textiles and clothing, Article 115 was used to restrict imports from the NICs, predominantly the Asian NICs, and China. The range of products involved is wide and a little bizarre. To explain the presence of such diverse items as imitation jewellery, slide fasteners and brooms and brushes, would necessitate a study of the influence of industrial lobbies in the member states.

Consumer electronics are well represented. There is a strong industrial lobby for protection in these products, and this is supported by the view, often expressed in official circles in the member states, that protection is warranted in these products since the Community is in danger of lagging in high technology and its applications. Compact disc players may not be 'the commanding heights of the economy' but they do incorporate advanced technologies that may have spin-offs elsewhere.

The Commission suggests that many QRs can simply be abolished because the relevant EC industry could withstand the extra competition, at least after further restructuring. This is apparently consistent with the halving of applications for Article 115 over the last ten years, though this reduction may partly be the result of third countries realising that deflection will be frustrated, particularly since member states may now apply to the Commission for 'surveillance'. This means that import licences must be obtained for each shipment, and is a clear signal that further deflection will lead to suspension under Article 115. However, surveillance measures have also fallen, though again this could be because of 'self-policing' by third country exporters.

Developing country exports for which EC QRs appear most likely are footwear, consumer electronics and ceramic tableware. If the SEM leads to existing bilateral quotas being replaced by EC quotas, protection would in general be extended, since imports into all twelve member states would be covered. Over the last three years Spain, whose productivity rates in the many sectors are still considerably below the Community averages, has made extensive

Table 3.3
Developing countries' manufactures subject to Article 115 in 1988 and 1989 (first seven months)
(excluding textiles and clothing)

EC country	*Product*	*Exporting countries*
I. Import exclusion		
France	Footwear	Taiwan
	Slippers	China
	Umbrellas	Taiwan,Singapore, China
	Toys	China
	Car radios	Korea,China
	Televisions	Korea,Taiwan
Italy	Footwear	Korea,Taiwan
	Silk	China
Spain	Umbrellas	Taiwan
	Handtools	China,Taiwan,Hong Kong
	Sewing machines	Brazil,Korea,Taiwan
	Televisions	Korea
	Slide fasteners	Taiwan
	Video recorders	Korea
	Imitation jewellery	Korea
	Cars	Korea
II. Surveillance[a]		
Belgium	Brooms and brushes	China
Denmark	Bicycles	China
France	Footwear	Korea,Taiwan
	Umbrellas	China,Taiwan
	Radio aerials	China,Korea,Taiwan
	Televisions	Korea,Taiwan
Greece	Electric motors	Taiwan,Hong Kong
	Batteries	Taiwan,Hong Kong
	Electric transformers	Taiwan,Hong Kong
	Toys	Taiwan,Hong Kong
Ireland	Footwear	Taiwan
	Tableware	China
Italy	Silk	China
	Slide fasteners	Taiwan
United Kingdom	Leather gloves	China
	Footwear	China
	Tableware	China
	Colour televisions	China

Notes
a. excluding surveillance allowed to Spain and Portugal under transitional arrangements.
Source: Commission reports

use of Article 115 and will no doubt support the endeavours of Italy and France, the other two principal users, to impose a wide range of EC quotas (see Faber and van Rietbergen, 1989).

Footwear imports from South Korea, Taiwan and China are subjected to quotas by various member states. Korean footwear is constrained by at least France, Italy and Ireland and Taiwanese footwear by the same states plus Greece, and there are also the unofficial quotas on, at least, UK imports. In 1987 South Korea and Taiwan supplied 33% of EC footwear imports but in the sensitive category of sports shoes they accounted for 65%. Some of the member states which impose QRs import higher proportions from these countries, for example Italy imports 45% of all categories and 70% of sports shoes, while others import less, e.g. Ireland (28% and 36% respectively).

The Commission has recently undertaken a safeguards investigation into the growth of footwear imports from Taiwan and Korea, but has not released the results. An EC VRA may be proposed for both these countries. A quota restricting them to, say, their average 1981/2 import volumes would imply 50% and 41% cuts from 1987 levels, and a loss of 170 m. and 89 m. ecu respectively in export earnings. However, the EC industry argues that quotas must be placed on all developing country suppliers, since Taiwan and Korea are establishing plants in Thailand and China in order to circumvent existing restrictions.

Table 3.4 shows the structure of EC footwear imports in 1987 and how that structure has changed since 1980. The strongest growth in volume has been from the East European countries, though the developing country exporters have succeeded in raising their export values by a greater amount. Now that quotas on Polish and Hungarian exports to the Community have been eliminated and those on Czech exports will soon be dropped, these countries will constitute a source of additional competition for the smaller producers who also concentrate on conventional leather shoes (especially Morocco and Brazil).

Applying VRAs exclusively to Taiwanese and South Korean footwear exports would benefit other producers, apart from China whose exports are in any event quota-constrained. The principal beneficiaries would probably be Brazil, Morocco, India, Pakistan, Thailand, Indonesia and the Philippines, as well as the newly-liberated exports from Eastern Europe. Imposing VRAs on these countries at current export levels or lower levels would be most damaging to those countries which are rapidly expanding their footwear exports to the Community — Thailand and Indonesia and, to a lesser extent, Brazil and India. The major EC beneficiaries of VRAs would be Italy, followed by Spain and Portugal.

Table 3.4
EC footwear imports, 1980 and 1987

	1987		*1980*		*av. growth 87/80*	
	tonnes	*m. ecu*	*tonnes*	*m. ecu*	*tonnes*	*value (%)*
Total	247,352	2,410	205,175	1,438	2.71	7.7
Class 1[a]	36,843	694	70,596	699	-8.87	-0.1
Class 2[b]	143,605	1,367	97,023	563	5.76	13.5
Class 3[c]	66,929	349	37,561	176	8.60	10.2
ACP	42	1	152	1	-16.79	-8.9
Maghreb	4,061	71	2,756	37	5.69	9.7
Taiwan	49,82	471	29,654	169	7.69	15.7
S. Korea	44,417	357	33,641	151	4.05	13.1
Brazil	7,310	156	5,098	65	5.28	13.3
China	44,455	130	12,301	32	20.15	22.2
India	7,778	110	4,848	38	6.99	16.6
Hong Kong	8,877	54	8,589	43	0.47	3.4
Thailand	7,021	53	234	1	62.56	70.8
Morocco	2,448	40	1,352	20	8.85	11.0
Tunisia	1,601	31	1,406	18	1.87	8.0
Indonesia	2,977	16	30	...	92.86	99.0
Philippines	2,265	16	1,600	10	5.09	7.6
Pakistan	3,586	13	3,183	7	1.72	8.2
Malaysia	1,323	7	3,498	10	-12.97	-6.0

Notes

a. developed market economies.
b. developing countries, excluding those in c below.
c. Eastern European countries, Soviet Union, China, Cuba and the centrally planned economies of South East Asia.
... less than 0.5.

As a result of 1992, Taiwan may find that it has to accept Community VRAs on its consumer electronics exports. Korea already 'voluntarily' restricts exports of the most sensitive items, and Taiwan is likely to be pressured to do likewise, although its Community market share is much lower (for colour televisions 6% against Korea's 15%). There will also be pressure from individual member states for EC quotas on other goods. For example, France would like to see car radios within the net. VRAs on ceramics would primarily be directed at Eastern Europe though China is a significant exporter to the Community and would probably be subject to restrictions.

Bananas and rum

In the run-up to 1992 bananas have become a particularly contentious issue. This is because of the special privileges that certain producers have in particular member state markets, privileges that will have to disappear or at least be radically re-designed once open borders within the Community are established.

World exports of bananas are dominated by Latin America. In 1988 the region accounted for 71% of world exports, 29% of it from Central America. Exports from the ACP and the EC overseas territories (the Canary Islands, Madeira, Guadeloupe and Martinique) accounted for 16% of the world total in 1988. The fastest growth rate has been that of the ACP countries, in particular the Windward Islands. Exports from St Lucia and St Vincent quadrupled between 1980 and 1988, while those from Africa fell by 17%. Among the EC producers the exports of Guadeloupe and Martinique more than doubled over the period. This growth of EC and ACP exports is entirely attributable to increased demand in the Community. In some cases the Community accounted for all (Martinique, Guadeloupe) or over 90% (St Vincent, St Lucia) of banana exports.

At present somewhat less than half the EC's supply comes from the ACP states and the Community itself (Crete) or its overseas territories, while the rest consists of 'dollar' bananas almost entirely from Central and South America. The former enter the EC under special arrangements designed to preserve traditional markets. Thus Britain provides a guaranteed market for unlimited quantities of bananas from the English-speaking Caribbean and Suriname (at least up to the total British consumption). France and Italy provide similar guarantees for the French overseas departments, Cameroon and Côte d'Ivoire, and for Somalia respectively. Greece, Spain and Portugal prohibit, or substantially restrict, imports of bananas other than from Crete, the Canaries and Madeira respectively. For a number of the ACP countries and overseas territories of the Community, bananas constitute a significant share of total merchandise exports — Guadeloupe and Martinique 50%, St Vincent and the Grenadines 40% and Somalia 20%.

Table 3.5 indicates the broad geographical breakdown of EC imports. In recent years consumption of bananas in the Community has been expanding rapidly, as indeed it has throughout the developed countries. Per caput annual consumption has reached some 17 kilos in Sweden — the highest in the OECD — 12 kilos in Germany and 9 kilos in Belgium and the Netherlands. In France,

Table 3.5
Community imports of fresh bananas, volume and value and growth rates, 1984 and 1988
('000 tonnes and m. ecu)

	Volume '000 t.		*growth*	*Value m. ecu*		*growth*
	1988	*1984*	*%*	*1988*	*1984*	*%*
Total	2,881	1,854	11.6	1,583	1,044	11.0
Total excl. Spain, Port.	2,503	1,854	7.8	1,334	1,044	6.3
Developing countries	2,807	1,821	11.4	1,538	1,022	10.8
Canaries		343	-		243	-
EC overseas territories[a]	309	280	7.9	202	167	4.9
ACP	514	336	11.2	336	217	11.6
Latin America	1,603	1,192	7.7	741	631	4.1

Note

a. Guadeloupe, Martinique, St Pierre and Miquelon, Caymans, French Guyana.

Source: Eurostat, *External Trade of the Community, Analytical Tables,* various years.

where prices are higher, consumption is only some 8 kilos per head and in the United Kingdom it is only about 6 kilos per head. A number of reasons lie behind this growth including the increased popularity of convenience foods allied to greater concern about diet. Bananas provide a unique combination of convenience and nutritional properties. Secondly, over the last five years world market prices have benefited, at least in the short run, from being denominated in dollars while the dollar has been broadly on a downward trend since early 1985.

If the present system of protected markets for traditional suppliers were maintained, these differences would probably increase. Improved plantation techniques, including the treatment of disease and harvesting methods, together with increased capital inputs (aerial tramways, windscreens, etc.), better handling and improved shipping facilities, are all likely to keep down the price of dollar bananas on the European markets and increase the price differential vis-à-vis bananas from the Caribbean. The latter together with EC production from Madeira, Crete and the Canary Islands[7] will become increasingly uncompetitive against, not only dollar bananas, but also bananas from the ACP countries in Africa, in particular Côte d'Ivoire and Cameroon.

Because it depends on the insulation of certain member state markets from intra-EC trade, the privileged position of the ACP and EC suppliers (in EC parlance the 'traditional' suppliers) necessitates frequent recourse to Article 115. At present a common trade regime for bananas only exists among Ireland, the Netherlands, Benelux, Denmark and Germany, and, even so, Germany is distinguished by its tariff quota of dollar bananas. Commission officials and member state politicians have repeated commitments to maintain preferential access for the traditional suppliers after 1992, but the current preference margin is unlikely to be adequate to sustain their exports. Most of the protected producers are small-scale and relatively inefficient and, given their topographical disadvantages, even with major restructuring of the industry, their costs would remain considerably higher than those of the large plantations of Central America, Colombia and Ecuador. On the other hand, the present tariff on dollar bananas is bound under the GATT. Any attempt to negotiate a rise in the tariff would be resisted both inside and outside the Community.

Indeed, the GATT regulations prevent any rise in the average tariff rate. Since the Community *qua* customs union, let alone *qua*

SEM, implies a Common External Tariff, it is generally accepted that the present German tariff quota — which is raised annually in line with consumption — will have to be abolished. To avoid a rise in the average level of protection the Common External Tariff (CET) would need to be cut to roughly 14% across the Community. If this were not done the dollar banana producers could demand a GATT ruling and it would be embarrassing for the Community to be put into the dock during or immediately after the Uruguay Round.

A wide range of possible arrangements have been suggested for continuing to protect ACP and EC bananas while respecting, to differing degrees, the 1992 principles of free circulation and enhanced competition within the Community. These extend from a fully-fledged Common Agricultural Policy regime for EC bananas (complete with guaranteed prices and intervention buying) and quotas on non-EC bananas to protect the ACP market share to a free market with limited financial arrangements to compensate EC and ACP producers. The differences in proposals reflect differing goals, and at least to some extent different readings of the Protocol to the Lomé Convention. This states that 'no ACP state shall be placed, as regards access to its traditional markets and its advantages on those markets, in a less favourable position than in the past or at present'. The protocol also speaks of 'improving the conditions under which the ACP States' bananas are produced and marketed'. Any opening up of the Community market in bananas is likely to be accompanied by measures to

— help the ACP, and EC, producer countries to reduce costs by introducing plantation techniques where appropriate, and to eliminate disease and improve transport facilities, thereby enabling a higher proportion of their current production to compete with dollar bananas,
— help finance diversification into other crops or non-agricultural activities, and
— to some extent compensate directly the governments of the producing countries for any shortfall in earnings on banana exports relative to an agreed base year.

While such measures are superficially attractive, they are unlikely to be regarded by the protected producers, or their lobby in the Commission, as a satisfactory alternative to some sort of market regime. Because of their natural disadvantages the Caribbean producers, in particular the Windward Islands and Jamaica, are unlikely to become competitive with those in Latin America even with substantial technical and financial assistance. Also opportunities for diversification are extremely limited in the Windward Islands. Tourism is the most obvious alternative but, for social reasons, there is a reluctance to replace dependence on bananas with dependence on tourism.

Among the many proposals of arrangements for bananas under the Single European Market, two alternatives can be dismissed. First, the CAP-type regime would be resisted as too costly, against the Uruguay Round commitment not to establish new barriers to trade, and generally against the trend towards liberalisation of agricultural markets. Secondly, the indefinite continuance of the present system can be ruled out, except possibly as a temporary arrangement. It would mean giving derogations from the Single European Act to allow the United Kingdom, France, Spain, Portugal and Italy to continue to impose national import controls and to outlaw imports through other member states. This implies continued use of Article 115, which may be legally possible but will be made difficult by the absence of frontiers. The system would be subject to legal challenge — which might well come in a case brought to the European Court by one or several of the multinational banana importers — and, in any event, several member states simply would not accept that such a derogation to the principle of free circulation be allowed from the beginning of 1993, particularly for an item as relatively unimportant to most EC consumers as bananas. This would be the case even were intra-EC frontiers to be maintained.

Three principal options remain:

— a free market though with the present 20% tariff on dollar bananas throughout the Community and the elimination of the present tariff-free quota of dollar bananas imported into Germany. This would go with substantial aid payments to the ACP countries and EC regions in the form of structural funds for diversification and direct income or balance of trade support,
— a free market with a deficiency payments scheme for ACP and EC bananas and
— a quota system for dollar bananas with various forms of aid to preferential producers (which would not be related to the price or quantity of bananas they sold on the EC market)
— or some combination of these options.

In the case of the quota scheme there is a further 'sub-option'. It could be combined with a licence system for dollar bananas, with licences issued subject to commitments (backed by financial deposits) by the importers to sell given quantities of EC or ACP bananas. Such a scheme is favoured by certain milieux in Brussels but will be resisted by Germany, the UK and other member states in that it goes against the trend towards market deregulation.

Using a partial equilibrium model of the EC banana market a number of alternative arrangements were simulated for this study. The detailed results are given in Appendix 2. Here we draw some conclusions about the impact of the alternatives on the banana producing countries.

A free market, with the CET as the only trade barrier to EC imports, is not likely to be adopted in the foreseeable future. Nevertheless, it does demonstrate the costs of distorting the market to provide for the less efficient producers. The main costs of special arrangements for the EC/ACP producers is not the cost to the Community budget, though that could be sizeable, but the cost in loss of consumer surplus. This can be appreciated by comparing unit prices paid in a free market with those paid under any other option.[8]

In a free market prices in the currently protected markets would fall approximately to the price of dollar bananas in the quantitatively unrestricted markets — Belgium, Denmark, Ireland and the Netherlands. This is roughly 45 ecu per 100 kilo, as opposed to 70 ecu for Community bananas, 60 ecu for Windward Island bananas and 45-60 ecu for African bananas and bananas from Suriname and Belize. If the CET had to be reduced to compensate for eliminating the German tariff quota, the price in the unrestricted markets would also fall.

Some of the preferential suppliers can compete better than others — e.g. Belize, Suriname and the African producers (Cameroon, Côte d'Ivoire and Somalia). Martinique and Guadeloupe, being subject to French minimum wage legislation, are bedevilled by high labour costs, but even apart from that they are high-cost producers. They and the Windward Islands would only be able to compete if they were to achieve substantial reductions in their production costs.

If this option were adopted, substantial compensation would need to be paid to the ACP (and EC) producers. The costs to the Community budget would be by no means as vast as has sometimes been assumed, partly because a share of ACP production could become competitive and because of substantial increases in tariff revenue. In a pure 'decoupled' income-support system, the budgetary cost, net of increased tariff revenue, would be independent of the extent to which the EC and ACP producers could become competitive. One way of assessing the compensation payments would simply involve multiplying export tonnages by farm-gate prices less imported inputs in some base year. If compensation were set at 165 ecu per tonne, the budgetary cost would amount to less than 200 m. ecu (all calculations based on 1988 price and export volume data). This compares with a Lomé IV financial package of 10.7 bn ecu. Moreover, this expenditure would be largely offset by increased tariff revenues from dollar banana imports into the Community.

Despite the apparent attractions to the Community of a liberal market plus generous compensation for lost ACP and EC sales, it is strongly opposed by groups in the Community who argue that there is a commitment to maintain existing markets for all ACP suppliers. There are worries about the social consequences of 'paying off' the traditional producers.

A deficiency payments scheme would also involve a free market in the Community, except that EC and ACP producers would receive the world price plus a differentiated amount of income support for each kilo of bananas exported to the Community. Producers would be guaranteed at least, say, 700 ecu/tonne for EC producers and 500 ecu/tonne for the ACP producers. Again there would be strong incentives for EC and ACP producers to become more efficient. They would have to compete for market share with the dollar producers and among themselves. But as the deficiency payment for EC/ACP producers would be the same, the higher-cost EC producers (Crete and Madeira) and the higher-cost ACP producers (the Caribbean islands) might not be able to compete with the more efficient EC and ACP producers respectively.

The cost to the Community could be high, depending on the level of guaranteed prices, though there would be offsetting revenues for the Community in the form of tariffs on the increased imports and unit values of dollar banana imports. From the point of view of the dollar suppliers, the effect of the deficiency payment system would differ from that of a free market since their market share would be less. Depending on the magnitude of the deficiency payments, more of the Community/ACP producers would be able to stay in business.

A quota system would mean setting quantitative restrictions on the tonnage of banana imports from the dollar suppliers. They would probably continue to be subject to a tariff though not necessarily at the current rate of 20%, while imports from EC/ACP sources would not be restricted by quota or subject to tariff. Prices would rise within the EC unrestricted markets and fall in the restricted markets.

If the overall quota for dollar bananas were set at the average level of imports over some base period, the EC/ACP producers would not find that their earlier privileged position was preserved. Unless there were improvements in their productivity, stimulated by increased competitive pressures (i.e. an outward shift in their supply curve), exports of their bananas would fall. Apart from minor differences due to transport costs, a common price would prevail throughout the Community. This would settle at somewhere between the prices in the currently protected markets and the current average price in the unrestricted markets. Many EC/ACP producers would not be able to supply at the new price.

In the event of a quota system being adopted, three crucial questions need to be decided:

— the initial overall quota size. Clearly the impact on the EC/ACP producers will depend on the size of the quota(s).

— the growth in quotas. One possibility is a quota system with gradually increasing quotas over time, with an unallocated quantity to ensure that to some extent the increase in consumption is met by the most efficient suppliers. There is debate as to whether annual increases should be guaranteed *ex ante*, and for how long, or depend *ex post* on market growth, and whether the EC/ACP producers should also be guaranteed a share in market growth. If they were, the gainers would to a large extent be the African suppliers, where the multinational banana companies are showing increasing interest.

— the administration of the quota. This is important, first, because if quotas were established bilaterally for each dollar country, the price in the Community would rise more than if they were established for all dollar countries as a whole and these countries had to compete for market share. It would also introduce rigidity into the system, as the distribution of quotas would be difficult to adjust over time. Secondly, the price could be kept down by auctioning the quotas and securing the economic rent for the Community budget. Thirdly, subject to a global quota, licences, which could be marketable, could be issued to traders on the basis of previous traded volumes to import from whatever dollar producer they chose. The problem here would be that the additional profits (or economic rents) generated by the quotas could be largely 'creamed off' by the multinational trading companies. In order to avoid disruptions caused by a scramble on the part of traders to satisfy a quota, particularly a global quota for all dollar producers, the annual quota would probably have to be divided into monthly subquotas.

A mixed scheme of deficiency payments and quotas on individual dollar exporters could be tuned to leave the volumes of EC, ACP and dollar exports unchanged. The volumes are constrained by the quotas and the guaranteed prices offered the EC and ACP producers could be differentiated so that the guarantees were taken up by the EC but not by the ACP producers. The market price in the Community would settle at considerably above the world price, with the dollar exporters earning revenues over 20% higher than in the base year. If the Community wanted a scheme which did relatively little damage to EC and ACP export earnings at limited budgetary cost, a mixed scheme of this sort is an obvious candidate. The costs are considerably higher prices and greater loss of consumer surplus in the Community. Basically the consumers would be financing the scheme.

The Uruguay Round does impose some restraint on the arrangements designed to safeguard EC/ACP producers. At Punta del Este, the Community committed itself to 'the fullest possible liberalisation of trade in tropical products'. The fact that bananas are excluded from the Tropical Product Negotiating Group's ambit does not completely eliminate some linkage. Moreover, if a quota system is adopted, the potential recourse of Latin American producers to the GATT complaints procedures in the months after the Round is formally completed will certainly be a major factor encouraging the Community to be generous to them in its proposals. It may also be argued that, in the current climate, it is critical that the Community should not be seen to adopt — or propose — a solution to the banana problem that increases the overall level of protection against the dollar producers. Thus it may be felt necessary to reduce the tariff on dollar bananas, say to 10%, to offset the additional protective element inherent in the quota.

It might also mean that the quotas will take the form of Voluntary Export Restraints, negotiated independently with the dollar banana producers. This means that those countries would be in a stronger position to expropriate the economic rents vis-à-vis the multinational trading companies. At the same time it means that the final market price in the Community will be higher and the ACP and EC producers — or at least the more efficient of them — will have a rather better chance of maintaining some market share.

To sum up, the opening of the EC market in bananas will have dramatic implications for the high-cost producers, in particular the Windward Islands and Jamaica among the ACPs and Crete, Madeira, Guadeloupe and Martinique in the Community. The gainers will be the dollar banana producers and, possibly, the EC consumers, with both groups gaining more the closer the regime approaches a free market. Only if a deficiency payments system with very high guaranteed prices were introduced, could the EC/ACP producers (as a group) come out better and the dollar producers worse than under the present arrangements.

To some extent the Latin American producer countries and the international trading companies are preparing for a more competitive market. Small and medium-sized independent producers have been expanding their acreage and investing in improved transport and packing facilities throughout Central America, Venezuela and Colombia. A 'banana war' over supply contracts with independent producers in Honduras has broken out between two large companies, Chiquita Brands and Fyffes.

Rum: The rum protocol to the Lomé Convention is not *per se* contrary to the objectives of the internal market. It allows for a quota, equivalent to at least 170,000 hectolitres of pure alcohol, to be imported duty-free. In order to protect EC distillers, and, in particular, to ensure a market for French rum (from French overseas departments), which would not otherwise be competitive, the EC quota has been subdivided each year among the member states, and the United Kingdom which has the largest share has been barred from re-exporting to the other members. The Commission argues that the subdivision of the quota is contrary to the Treaty of Rome and has not proposed modifications to the protocol. With the abolition of customs posts, it will not be possible for France to exclude rum from elsewhere and there might be a move to reduce the EC quota or vary the protocol in some other way. However, this may be considered unnecessary if a sufficiently ambitious scheme for regenerating the industry in the French departments is undertaken. The French Government is currently examining the potential for such a scheme. To some extent it would be financed by 'Posiedom', a 'programme of options specific to the remote and insular nature of the French Overseas Departments' and would thus benefit from the Community's Structural Fund.

Notes

1. Several other developing countries are restricted through different mechanisms. In particular, Turkey and the North African suppliers are limited through their Association and Co-operation Agreements with the Community.
2. For a general discussion of the interpretation of quota utilisation rates, see Erzan, Goto and Holmes, 1989.
3. To allow for inevitable informational deficiencies, timing problems etc., it was assumed that any member state with a utilisation rate of 95% or more was quota-constrained. The import data covered the period 1 January 1987 to 31 March 1988 since, in the first three months of the year, imports may be counted against the previous year's quota.
4. Many of the restrictions apply to horticultural goods which operate under the 'import calendar' system where different trade regimes, EC as well as member state, apply to the same good over different periods of the year.
5. There are also 'monitoring' arrangements limiting exports to the EC. For example, South Korea restricts exports of, at least, video recorders, compact disc players and colour televisions.
6. The possibility that certain QRs or VRAs are enforced at intra-Community borders without the use of Article 115, though contrary to the Rome Treaty, cannot be excluded, since it would not necessarily be in the interest of the original exporter to make a complaint. Here information is totally lacking.
7. The Canary Islands are a Spanish province. Although they are not part of the EC they export bananas duty-free to the EC. Madeira and Crete are within the EC.
8. Calculations of consumer surplus as such are not given. They require that the entire demand curve be specified — not merely the elasticity between the initial price and any new price. Comparing unit prices under different schemes is an adequate indicator of consumer gains or losses in the Community.

4
Harmonisation of Technical Standards and Taxes in the EC

Technical standards

The developing countries are naturally fearful that their exports to the Community will be adversely affected by the mass of harmonised technical standards which are being adopted as part of the SEM programme. Those most likely to cause them problems concern exports of plants, fish and meat and the various products of these. The main directives which concern imports from third countries on plant health (phyto-sanitary regulations), animal diseases and 'human health relating to animal products' (sometimes known, bizarrely, as animal hygiene) have been in place for some years. For fish and fish products a new batch of regulations has been tabled, though they have not all been accepted by the Council of Ministers and the details of implementation are still to be decided. In addition, a set of 'horizontal' rules concerning maximum levels of antibiotic and pesticide residues has been in operation for several years.

Where higher standards create problems, they can generally be met by appropriate investment programmes — in the agricultural and fishery sectors usually in raising standards of hygiene through pollution controls or improved processing facilities. It is difficult to get a sense of the economic significance of these investments but in certain cases they could be considerable.

In the case of plant health, each consignment cleared at the EC border will be issued with a 'plant passport' which will guarantee free circulation throughout the Community. There is also the possibility of negotiating the consent of third-country suppliers for pre-export inspection, probably to be undertaken (or at least controlled) by the newly-formed EC Plant Health Inspectorate, which will also have the task of overseeing member state inspection of third-country imports. Thus higher standards are going to be instituted *de facto*. These are most likely to impinge on exporters of tropical timber, planting material and cut flowers.

In recent years a number of countries, including Kenya, Sri Lanka and Colombia, have built up a major export trade in flowers, sending in the main carnations, roses and alstroemerias to the Community. With the advent of the 'plant passport' system and a Community inspectorate, these will undoubtedly be submitted to more thorough border inspections in future. Plant growers in certain member states have been complaining about the presence of tropical pests in their greenhouses, including thrips from Kenya. Such pests can be controlled without great expense, but harassment of exports of flowers from developing countries may take place, not so much motivated by protectionism but rather to establish the credibility of some member state inspection services. In general, these health and hygiene and phyto-sanitary rules are not intended simply to ensure the quality of the products coming from third countries, but also to allay the suspicions of certain member states that certain other member states are too relaxed in their interpretation of existing rules.

As regards animal health and hygiene (i.e. fresh meat), most of the regulations are now in force. The principal issue is whether there will be a major tightening up in the stringency with which they are implemented. In the case of meat products, there is at least one potentially important new directive. For meat products to be allowed into the Community from third countries, the slaughterhouses and processing plants must be licensed by EC inspectors. There is also a proposal to establish additional or tighter rules on veterinary inspection and health certification for each consignment, on wrapping and packaging, and conditions of storage and transport, as well as on inspection on arrival and conditions of transport in the Community.

At least in one important case it seems that provision has not been taken to meet existing rules on meat products. Riddell writes of the largest producer of canned meat in Zimbabwe, Lemco:

> Past policy appears to have been content to dominate the domestic market for canned beef. ..[T]here is little to indicate that [Lemco] aggressively sought to lower unit costs, at least to the extent of being able to penetrate the much larger European market or even to think much about expanding into the export field. A chain of factors have restricted such expansion. To export to the EEC requires EEC-registration of the canning factory, which would necessitate expanding

> and upgrading at a cost estimated at Z$ 1.5 m. a few years ago but no decision has been made on going ahead with this programme. (1990a, p.363)

The directive, which requires registration and has up till now prevented Lemco from exporting to the Community, appears to be that first proposed in 1984 (though it was not adopted till early 1989). The new meat product proposal tightens up the requirements and will make it more expensive to enable a processing plant to register.

Of all the new EC standards probably those with the greatest potential impact on the developing countries concern fish and fish products. Under the new regime the Commission will 'for each third country, lay down conditions for the importation of fishery products,' which may include establishing a list of processing plants and factory vessels which are authorised to export to the Community. How often inspections will take place will depend on 'the guarantees a third country can offer in relation with the checks carried at the place of origin' (sic) (*Official Journal*, C 84/58, 2 April 1990) which clearly leaves the Community inspector a large measure of discretion. In principle the same requirements are being applied to both member states and third countries but developing countries may suffer technological and economic disadvantages in, say, clearing their coastal waters or fish farms of pollution. Climatic conditions also tend to work against the developing country producers. Satisfying the new rules may necessitate considerable investment in sewage infrastructure or upgrading existing plant. The conditions for authorisation of plant and ships appear very demanding and give ample scope for denial of authorisation. How the regulation is implemented will be critical. It could also be significant for developing country exporters that the US authorities are studying the introduction of similar regulations. The 'copycat' adoption of tougher import standards by third countries is one of the potential systemic effects of the SEM.

The new EC regulations may cause particular difficulties for certain Mediterranean, African and South-East Asian suppliers of fresh or frozen crawfish, shrimps and prawns, squid, cuttlefish and octopus to the Community. The main exporters are Morocco, Tunisia, Mauritania, Senegal, Madagascar, Mozambique, Cuba, Argentina, India, Thailand and Taiwan. The North African countries are also major exporters of canned fish. Even under the older regulations, in February 1988 only 12 of Morocco's 60 fish canneries, for example, were on the EC approved list, the rest failing to satisfy standards of sterilisation. These regulations are unlikely to create difficulties for tuna or other salt-water species imported from Africa or South America.

There are also a set of so-called 'horizontal' food law directives, covering preservatives and other additives, frozen foods, labelling, rules for foods of particular nutritional uses and so on. Some of these are already in effect, with the rest due to be implemented by the end of 1992. It is hard to determine what problems they may pose for exporters. Any difficulties are likely to be limited to a few suppliers, but the new rules could in some cases impose relatively higher costs on developing country exporters and could be of significance to the countries involved.

At present some member states have different permitted lists for certain additives and some have derogations from the existing labelling directive. It is worth pointing out that prior to the 1992 programme, there were some 218 individual EC barriers with which outside suppliers of manufactured foods had to contend. Of these 64 were specific member state import restrictions, 68 were controls on labelling or packaging, 33 were bans on specific ingredients, 39 were rules on product description and 14 were instances of tax discrimination. By 1992 a single set of rules covering all member states should be in place.

Among manufactured goods other than foods, toys are an important export for South-East Asia, and these are now subject to the directive on toy safety. New producers will have an advantage in meeting tighter standards. For the established suppliers the edge will lie with those who can adapt their products quickly and cost-effectively, and in these respects it is not clear that the EC producers are better placed than the outsiders.

It appears that Togo and Senegal will be adversely affected by the new regulations limiting cadmium (and other trace elements) residues in fertilisers. This problem can only be addressed by investing in new, and expensive, plant to eliminate these elements, which is now the intention. For most manufactured products, however, the 1992 requirement is mutual recognition. Domestic producers are not subjected to testing or certification procedures, and exporters from outside will have to satisfy the requirements of only one member state to obtain certificates of conformity which will be valid throughout the Community. But two nagging worries remain. In many cases outside producers will still be required to pass those tests and obtain those certificates and, in the process, could come up against delays and bureaucratic harassment. Secondly, there is plenty of scope for bureaucratic, and perhaps unintentional but effective, protectionism on the part of customs officials who will have to determine whether a particular shipment is covered by a certificate issued by another member state. No proposals have been put forward for a system to ensure that regulations which ostensibly concern health and safety are not used as an unwitting or intentional protective device, though the Community is a signatory to the GATT standards code. However, it is unlikely that many developing countries would consider taking the Community to a GATT tribunal over the officiousness of certain inspectors or customs officials.

Tax regimes

The original Commission proposal was that all member state VAT and excise tax rates should lie within agreed bands and that excise taxes should be limited to alcoholic drinks, tobacco and mineral oils. There has been considerable difficulty in reaching the necessary unanimous Council agreement on Value Added Tax, though the principle of gradual approximation has been accepted. These are relatively unimportant issues as regards the developing countries. On the other hand, the abolition of excise duties on coffee, tea and cocoa is significant. The Community has made the elimination of excise taxes on tropical beverages a part of its offer to the Tropical Products Negotiating Group in the Uruguay Round. But the original stimulus came from the concern to harmonise indirect taxation as part of the 1992 programme.

In certain member states these taxes are substantial, reaching over 50% on coffee and tea in Germany. Thus there will be important consequences for developing countries' exports, even though demand tends to be rather insensitive to price. Their exports of coffee to the Community are enormous. Apart from mineral oil, they constitute the largest single commodity import at almost 4 bn ecu (1988 data) of which some 1.5 bn ecu was supplied by ACP states.

Table 4.1 shows the estimated effects of harmonising overall consumer taxes on coffee at 5% on the increase in the volume and value of developing countries' coffee exports.

Table 4.1
Coffee[a]: effects of the elimination of excise taxes and harmonisation of VAT at 5% in EC (based on 1987 data)

			%
Current EC weighted average excise tax on coffee			18.2
Current EC weighted average VAT rate			6.7
Current EC weighted average consumer tax rate			26.2
Assumed harmonised EC VAT rate			5.0
Change in EC imports (vol.)[b]			3.0
Increase in world coffee prices [b]			1.3
Price effect on non-EC imports (vol.)			-0.3
Change in volume of world exports			1.1
Change in value of world exports			2.4
		m. ecu	%
Increase in EC imports		200.9	4.3
Increase in rest of world imports		52.2	0.9
Increase in world imports		235.1	2.4
of which	Brazil	36.2	2.1
	Colombia	41.6	2.8
	Côte d'Ivoire	10.8	3.4
	Uganda	8.0	3.0

Notes
a. 'green' coffee
b. see Appendix 3 for a discussion of the elasticity assumptions.

The net increase in world imports of coffee from the tax harmonisation is estimated at 3.8% in value terms and 1.9% in volume. This implies a significant impact on the exports of coffee-producing countries — some of which have a high degree of dependence on coffee. At the same time, the monthly average absolute percentage deviation from trend of coffee prices over the period 1980-89 was 12.2%, which, while not detracting from the significance of the SEM gain to the exporting countries, does put it into perspective (UNCTAD 1990, p 378).

The reduction in coffee prices associated with the elimination of excise duties, together with the effect of increased incomes in the

Community (trade expansion), will not only lead to an increase in the volume of coffee imports but also to a rise in their quality. There are some econometric estimates of the price and income elasticities of demand for coffee but none takes into account quality differences. In the past increased incomes have apparently led to increased consumption of milds at the expense of robustas, with Brazilian and other Arabicas holding a constant market share (Neumann, 1990). If this trend continues, the Central American producers and Kenya, Rwanda and Tanzania will do rather better than under the constant market shares hypothesis, at the expense of Côte d'Ivoire, Uganda, Zaire, Cameroon and Indonesia.

The same tax regime for cocoa would lead to increases in world prices of 1.8% and EC import volumes of 1.4%, and would generate additional imports worth about 47 m. ecu. The principal beneficiaries would be Côte d'Ivoire, Nigeria, Cameroon, Ghana and Malaysia. A 5% harmonised consumer tax rate on tea would increase prices by almost 1% and imports by 0.2% in volume, leading to an increase in export earnings of 4.4 m. ecu. The countries gaining most in this case would be Kenya, India and Sri Lanka.

Tobacco is a special case. Duties on cigarettes in the most popular price category range from 0.12 ecu in Spain to 2.76 ecu in Denmark. In response to the outcry about the loss of revenue and health concerns in certain member states, the Commission has withdrawn its proposal that duties be aligned on the Community average. Instead, excise rates will gradually be harmonised upwards with negative consequences for tobacco exporters. If, for example, tax rates were aligned on the average of the four states with the highest rates (Germany, Denmark, Ireland and the UK), the EC average tax would more than double (from about 48% to 105%). This would lead to an average rise in prices in the Community of 10.3% and a reduction in EC imports of around 4.1% and a loss in developing countries' export earnings from the Community of 147 m. ecu (based on 1988 imports). This would be partially compensated by an increase in imports into the rest of the world following the reduction in world prices. Indeed, it is estimated that the net reduction in developing country export earnings as a whole would amount to only 63.2 m. ecu, with Brazil, Zimbabwe, India and Malawi bearing the brunt of the shortfall. The damage to the exporters could be alleviated through a liberalisation of the CAP tobacco regime and thus an end to EC dumping of low-quality tobaccos on the world market (see Davenport, 1988).

The elimination of excise taxes in Italy on bananas will help Somalia. The proposed harmonisation will also affect oil products. But it is unlikely that there will be any substantial increase in average rates which could have a negative effect on overall demand on imports.

5
Trade in Services

Many of the most important 1992 effects on services will be trade-creating within the Community and trade-diverting as regards third countries. Many services in which intra-EC trade was virtually impossible because of controls and regulatory structures, will be opened up. There is no reason, however, to expect significant extra-EC effects, as there is no commitment to reduce barriers to non-EC suppliers. Moreover, there are reasons for expecting stronger trade diversion effects in services than in most goods, and on trade-related services they are likely to be at least as great because they will follow the goods diversion. Where some trade was possible before, the removal of all intra-EC barriers will provide an incentive to switch suppliers, and as the 1992 initiative was not preceded (as in goods) by 35 years of reduction in barriers, the effects are likely to be all the larger. Had the early attempts to increase external barriers (for example in financial services) been successful, the diversion would have been even greater. But the reason for expecting diversion to Community suppliers and for most trade to be created within the EC, is more fundamental than this: many of the barriers to trade which the SEM is intended to reduce are related to previously non-freely traded services (in transport, banking, insurance most obviously), so that increasing EC trade in these and lowering their cost are of the essence of the SEM. This will normally make them more competitive than externally supplied services.

To the extent that there is a simple substitution within the Community of one member state's service for another's, the direct external effect is small (except for the efficiency effects considered in the analysis of goods integration). But if this leads to a real increase in that service's competitiveness in third markets, other suppliers could be damaged. Favourable effects on non-EC countries could only come if the lowering of internal barriers made it easier for external suppliers to obtain advantages of scale, provided the external barriers were not insuperable; or from lowering the costs of services imported from the Community; or from changes in particular regulations for particular services as part of the standardisation process; or, for income-elastic services, from the dynamic effects.

General trends in the international economy

Data on services are not good, and serious collection is too recent to identify trends with any confidence. The GATT Secretariat has recently published aggregate tables, based on balance of payments data (GATT 1989b). Western Europe was the major importer of services (1987 data), taking about 60% of world trade, and even higher than this for shipping, travel, and 'other'. Developing countries are only small suppliers of any of these, and among these only the Asian NICs are significant at world level.

World exports of services have grown at a similar rate to goods over the last 20 years, taken together (Hoekman, 1989). They grew slightly faster in the second half than the first, but only by 1-2 points. The rates remained similar for developed countries, but for developing countries the difference between services and goods became very large: 15% p.a. compared with 10% in 1977-82, and +0.6% in 1982-7 compared with -3.8%. One reason for the better performance of services in the 1980s was to be found in price, not volume (*ibid.*, p.10); this may indicate greater price stability for services than for primary exports. For countries dependent on primary products, however, this might be as great an advantage as strong volume performance.

Between 1979 and 1986 (the most recent figures available, Eurostat 1989), total EC imports of travel services from outside the Community almost doubled. Those from developing countries doubled, but the absolute rise was small. They represent about 18% of total imports from outside the Community. The share of the developing countries in total EC travel payments has risen slightly, from 41 to 43%. Although the rise for all services is substantially greater than for EC imports of goods (about 60% over the same period), showing that they are a promising sector, developing countries have not so far demonstrated a marked advantage.

While the overall share of the developing countries in world services exports may be small, for a number of these countries services exports are an important share of total exports. This is particularly true of Egypt (53% in 1987 up from 13% in 1970), Kenya (40% from 33%), Sudan (35% from 9%), Morocco (32% from 26%) and the Philippines (32% from 14%). These countries have experienced an increasing share of the services component. In the case of Israel and Mexico the share has diminished but still remains important (29% and 24% respectively).

The developing countries accounted for 16% of 'world' exports of commercial services in 1987, up from 11.5% in 1970, where the 'world' excludes Eastern Europe other than Poland, Hungary and Romania. The total value of developing countries' exports of commercial services in 1987 was some $81 bn, compared with merchandise exports of $475 bn. There is no precise way of determining the extent to which the Community was an importer of their services exports, though some rough estimates are given in Table 5.1.

Apart from the Asian NICs where transportation in the form of shipping is an important export, the service exports of the developing countries are dominated by travel, which exceeded 50% for 31 countries and 80% for eight (St Kitts, Bahamas, Gambia, Haiti, St Vincent, Grenada, Dominica, and Antigua). Balance of payments statistics do not separate the tourism component out of the travel account, but some indication of its relative importance can be judged on the basis of the 'purpose of travel' question in the regular survey conducted by the World Tourism Organisation. In almost all cases — the major exceptions being Bangladesh and Pakistan — tourism appears to be several times more important than other credits on the travel account. Nicolaides (1989) reports research showing that tourism is the single largest source of external revenue for the ACP countries. However, it is probable that imports constitute a large input into the production of most tourist services, while much of the infrastructure is owned by foreign companies. A lot more research is needed to determine the net benefit of tourist services to the exporting country.

Characteristics of tourism

Economic studies are normally cautious about attributing balance of payments or domestic output benefits to tourism for two reasons. First, on the grounds that the import component must be large. If tourism is compared to processing-based manufacturing or most other first-stage industrialisation, this caution seems excessive. (Tourism is more likely to be seen in this context than as a replacement for small-scale agriculture or large-scale civil services.) The direct labour and construction inputs will be largely local (except in those countries where these are delegated to immigrant workers by all industries and services), and the potential for backward linkages via local suppliers of other products and food is likely to be at least as great as in most manufacturing. Some of these effects will probably be easier to obtain in an already fairly developed economy, but most do not require more than intermediate-level skills.

The other reason for caution is a rather paternalist and elitist concern for the social effects of mass tourism. Some countries have suffered from poor quality, or more seriously, from criminal or semi-criminal activities associated with tourism, or from permanent environmental damage, but these are problems of lack of regulation, not of the industry itself. It is a major activity in international trade, which a developing country must at least consider as a potential export but which, like other industries, offers a variety of different products with different implications for use of labour, potential for foreign investment, direction of exports, and other industrial characteristics. Like other economic activities, it requires an appropriate legal framework and controls, including controls on foreign investors. To develop it successfully requires, as in other industries, clear objectives and the legal tools to achieve them. As in other industries, foreign investment frequently takes forms other than simple ownership, including joint ventures, licensing, management, etc., and in many cases offers the same advantages other than capital, including marketing and technical expertise and market access.

At the world level, according to the World Tourist Organisation, around 63% of all trips taken abroad are for holiday purposes, 14% for business purposes and the remainder for other reasons. Within total services, travel slightly underperformed all private services in the 1970s, and slightly outperformed in the 1980s, but by surprisingly little (6.5% compared to 5%), given the *a priori* assumptions usually made about its high income elasticity. By 1987, it represented about one quarter of total international trade in services. The WTO statistics, however, indicate a slowing of growth, taken by decades, from 11% p.a. in the 1950s to 9% in the 1960s and 5.6% in the 1970s. In the 1980s, after very slow growth during the recession of 1981-83, there was a temporary revival, followed by slow growth between 1984 and 1986; it grew more strongly in 1987 and 1988, when other trade also revived. Although it is an irregular series, the only actual falls since 1950 were in 1982 and 1983 (WTO, 1989).

There are some reasons to expect that the net price and terms of trade effects of 1992 on tourism may be positive for developing countries. Unit labour costs in the Mediterranean countries may rise. There may also be gains from standardisation of tax treatment within the Community: VAT will be imposed on services related to intra-EC tourism; removal of intra-EC duty-free privileges will raise the cost of intra-EC transport (by reducing the cross-subsidisation now provided) and possibly lowering its perceived benefits. The removal of capital controls has clear advantages for potential suppliers of services. Standard regulations for travel agents and for tour packages could raise costs in some countries but overall could reduce the perceived risks of more distant travel, and greater cross-country establishment of travel enterprises is likely to lower costs as in other services. Tourism is also believed to be one of the most income-elastic elements of consumer expenditure: a conventional assumption is 4, but lack of data has meant lack of econometric estimates (Davenport and Page, 1990, p.56).

Other services

The other services of most significance to the developing countries are maritime transport and aviation. Other things being equal, the demand for shipping and port services will rise roughly in line with trade. Since the primary product exports of these countries will be boosted by the rises in EC output and incomes consequent on the 1992 programme, even if trade in manufactures may remain broadly unchanged, there is likely to be some increase in demand for the shipping services. In 1987 Hong Kong, South Korea, China and Taiwan supplied over 5% of world shipping services and Singapore and Hong Kong nearly 4% of port services. Since 1987 these countries' shares have probably increased substantially. They are likely to gain from the increased trade following 1992. However, the Community has shown that it is prepared to take discriminatory action against shipping companies if they are alleged to practice 'unfair' pricing (Davenport, 1989). In 1989 the Commission imposed a countervailing duty on a South Korean shipping company operating a liner service between Europe and Australia.

Telecommunications are a service where there is a Community policy of liberalising national markets to improve efficiency. The direct policy changes are likely to be confined to EC producers, so except insofar as national governments may extend these to non-EC suppliers, this will give trade creation (at the expense of domestic suppliers) within the Community, with only diversionary effects outside it. Developing countries could gain in absolute, but not relative, terms from any increase in world-wide efficiency.

Financial services are one of the areas where there has been most controversy over the implications of 1992. The present proposals to grant more favourable treatment to established institutions than to potential new entrants would have a disproportionately damaging effect on developing countries as they are only beginning to move into this area. The implications for them are probably similar, therefore, to those of telecommunications.

English-language publishing has traditionally granted exclusive marketing rights to one publisher within each anglophone country by means of industrial agreements not to import from others, or from non-anglophone countries, which are 'open' markets. Such industrial barriers cease to be valid after 1992 (if, in fact, they are legal now), permitting greater access for non-EC suppliers: the United States would be the major immediate beneficiary, but developing countries where lower costs have permitted lower prices could also benefit. The change could, however, lead to greater reluctance to permit lower-cost editions in those markets.

A small but rapidly growing area in which developing countries have been increasing their market share is data processing and programming. Trade creation is likely here, because this sector is closely related to the level of trade and national output. As it involves recent innovations, its growth is likely to be substantially faster than output, at least up to some level. It is not location-specific and so far not subject to tariffs or non-tariff barriers so that non-EC members can compete on equal terms. Nor is it subject to transport costs or fixed transport routes, but it does depend heavily on excellent and reliable communications.

Quantifying the SEM effects on trade in services

Assessing the importance of 1992 to individual countries is made difficult by the absence of bilateral data on most services trade. This inevitably leads to emphasis on those sectors for which such data do exist, notably tourism and (subject to various recording problems) shipping.

Table 5.1 presents some estimates of the trade creation effect for developing countries' exports of services to the Community. The total amounts to just over 1.2 bn ecu, based on estimates of services trade in 1987 and 1987 exchange rates. Most of this effect will derive from increased sales of tourism, though trade-related service exports, which are assumed to rise *pari passu* with the volume of merchandise exports, are estimated to increase by about 0.25 bn ecu. These estimates are very rough, both because of the uncertainties regarding the underlying estimates of services trade in 1987, and because they are based on crude assumptions about the determinants of services trade, on which little analytical work has been done. For example, we are unaware of any econometric estimates of price or income elasticities of tourist expenditures — largely, one assumes, because of the paucity of the basic data. These are, however, improving.

Just as with trade in manufactures, the developing countries will find an improvement in their terms of trade if the 1992 programme leads to a reduction in the export price of services which they import from the Community. The earlier discussion raised the possibility of third-country gains from the improved efficiency of Community firms selling in particular telecommunications and financial services. In fact the Commission background studies for the Cecchini Report expect considerable price reductions in services within the Community as markets are opened up to competition among the member states, economies of scale are realised, rationalisation takes place and inefficiencies are eliminated. Most of these stem from the elimination of the regulatory barriers which currently prohibit or, at least, raise the costs of establishment of foreign financial service companies. After 1992 banks and other credit institutions, brokerage houses, insurance companies and other financial companies, established in one member state, will be able to sell their services throughout the Community, subject to certain EC rules, for example, governing solvency ratios, but in general under the regulations of the 'home' country.

The Commission study (1988c) found large differences in prices charged for a sample of financial services in the member states. The study led to an indicative price reduction for the Community as a whole of 10%. To the extent that developing countries are purchasers of financial services, they can already, to some extent,

Table 5.1
Estimates of trade in marketed services between EC and developing countries, 1987, and 1992 effects (bn ecu)

	Ldc exports to EC	*1992 effects*	*EC imports from ldcs*	*1992 effects*
Trade-related Services[a]	8.3	0.2[b]	6.7	-0.3[c]
Investment-related services[d]	3.6	0.0	9.2	-0.4[c]
Travel[e]	4.9	1.0[f]	2.8	0.0
Other	5.9	0.0	6.6	0.0
Total	22.7	1.2	25.3	-0.6

Notes

a. sea- and air-freight, other transport, insurance on transport and 50% of banking services. 1984 data from *The European Community's External Trade in Services* (Statistical Office, Luxembourg, 1986) on services trade between the EC-10 and non-OECD countries were scaled by the share of developing countries' merchandise trade (exports and imports) in non-OECD EC-12 trade and extrapolated by merchandise trade growth rates to 1987.

b. EC imports of developing countries' trade-related services assumed to increase by same percentage as EC imports of developing country merchandise.

c. balance of payments cost of EC services exports to developing countries assumed to decline by 4% because of lower EC prices.

d. property income, non-merchandise insurance, construction, engineering and 50% banking services. 1984 data on trade with non-OECD countries were scaled as in (a) and extrapolated by growth of total direct foreign investment in the developing countries from 1984 to 1987 (OECD 1989).

e. 1984 data on trade with non-OECD countries were scaled as in (a) and extrapolated by growth of developing country travel credits and debits from 1984 to 1987 (IMF, *Balance of Payments Statistics*, 1989, Vol.2).

f. assuming a 1992-related rise in EC disposable income of 5% and an income elasticity of 4.

select the lowest-price supplier. In some circumstances, for example where the services are trade-related or related to direct investment projects, the country may be constrained to buy services from an individual member state and, in these cases, price reductions could be of significant value. This will not necessarily change with the SEM, though in the case of bilateral aid, where related imports are tied to the donor country, the 'untying' of aid could yield significant benefits to the recipient countries, not least through 'comparative shopping' for financial services. The 'untying' of aid is discussed in the next chapter.

The same is true of the whole range of business services, including engineering, communications, computing, legal services, accountancy and managerial consultancy. The Commission study (1988d) suggests a figure of about 3% as a central estimate of the price reduction, albeit with a wide margin of uncertainty.

Other service sectors where market integration should lead to some significant price reductions associated with increased competition and restructuring, include air transport and telecommunications. The Commission (1988a) puts the average EC price reductions in these two sectors at about 5%.

A rough indicator of the reduction in prices for market services bought from the Community as a whole would appear to be of the order of 3-5%. Unfortunately data on the value of developing countries' imports of market services are very patchy. On the basis of a 4% price reduction, the gains to these countries from lower-priced service imports from the Community would amount to some 640 m. ecu (see Table 5.1).

6
Capital Flows to the Developing World

Tied aid

A single trading bloc suggests that, if aid is tied to the procurement of goods and services, it should be tied to EC exports rather than to those of individual member states. Indeed, it is not clear that the present system of member state aid, predominantly tied to procurement in the donor country, does not infringe the Treaty of Rome. In any event, any reduction in conditions on aid procurement could benefit the recipient countries.

In 1987 the eight EC states on the OECD Development Assistance Committee (DAC) gave a total of $13.63 bn in bilateral aid to the developing countries. Six countries reported the extent to which this aid was tied. 57% of their aid was partially or entirely tied to imports from the donor country.

The use of aid as an instrument for export promotion by the donor country significantly reduces its value to the recipient country. There are a number of ways in which tied aid will distort the pattern of trade and thus the development process:

— donors will support projects with relatively high import requirements and which will lead to orders in the sector of their domestic economy they want to stimulate,
— aid will be channelled to countries with relatively high per capita incomes or wealth at the expense of the least developed,
— donors will be reluctant to co-operate because they will view other donors as potential competitors in search of commercially attractive projects,
— donors who emphasise tying are less credible as partners in the policy dialogue with recipient countries,
— the practice of tying will reduce the willingness of donor countries to participate in multilateral aid (Netherlands National Advisory Council for Development Co-operation, 1989, p.74).

Assuming that 57% of EC aid is currently tied and that gains of the order of 20% result from the recipient countries being able to buy from the cheapest EC source (plus some additional competition among Community companies in supplying the goods or services), the increment in the value of that aid in 1987 would have amounted to $1.6 bn.[1] On the other hand, if the levels of exports to recipients showed signs of a downturn, some donor states could become less committed to maintaining bilateral aid levels.

Secondly, a formal agreement to end tying by the member states, or to tie to procurement within the Community rather than in the donor country, does not eliminate opportunities for informal conditionality. 'For example, a donor country may provide technical assistance so that projects are prepared in such a way that aid funds are allocated to suppliers in this country even though they are not tied. This means that the abolition of informal tying will not necessarily lead to the eradication of this phenomenon' (Netherlands National Advisory Council, 1989, p. 75).

Public export credit guarantees are treated here, for convenience. The motives for establishing export credit agencies are not very different from those for tying aid. At present each member state has its own export credit agency. The choice of countries for which insurance is made available, together with the credit limits, depends as much on political ties and historical associations as on credit risk. Each official member state agency provides insurance only for its own exports, apart from small subcontracts in other Community countries.

The wholesale replacement of the existing agencies by a single Community agency is unlikely but that does not rule out an EC-wide agency with limited responsibilities, for example restricted to medium-term developing country risk, and even restricted to contracts sourced in more than one member state. It would be in the interest of the developing countries if the new arrangements helped EC companies from different member states to collaborate in investment projects.

Even if a Community agency were not to be set up, developing country importers should gain from increased competition within the EC among private sector export insurers. Already, in some member states, private sector firms which offer quick decisions and a comprehensive set of complementary services are effectively competing against the public sector agencies, despite the subsidisation of the latter. The more successful private firms will increasingly compete throughout the Community.

In the export credit area most important 1992 decisions have still to be taken but, in any event, a likely outcome will be reduced public participation in the short-term market. Here any loss in subsidisation could well be compensated by improved services and increased competition within the private sector — though the burden of increased reserve requirements remains a problem. In the medium-term market, particularly for the higher risk cases, a significant reduction in subsidisation could be critical. But, at least at the present, the centralisation or harmonisation of subsidies seems the more probable outcome of the current discussions.

Private investment flows

Most of the SEM's implications for investment in developing countries appear to be negative. Removing barriers to capital flows and improving information to permit companies to treat the Community as a single market are central to the programme, and, as in services, the next few years will see the initial adjustment effects to a new regime, not merely the continuation of a process, as in the further liberalisation of goods. Any trade diversion effects will have immediate consequences for goods-related investment. The obvious one is an increase in investment in the Community by those currently engaged in intra-EC trade and a decrease elsewhere by those currently exporting to it. But there could be a substantial adjustment effect from traders moving into the Community because of the reduction in cost from operating within the integrated market. In addition, there will be the effects of the relative rise in the level and growth rate of demand, and from the opening of the market for financial and other investment-related services. And the removal of exchange controls by France could divert investment away from the franc area. All these effects will be reinforced by increased awareness of opportunities in Europe. Investment does not take place as a series of marginal decisions in a perfect market with a large number of decision-makers, but by a relatively small number of economic actors in a market where the spread of information is a significant determinant.

There will be serious obstacles to measuring any changes in investment. For other reasons investment in the developing countries has slowed up and data for current (or even past) performance are uncertain, offering a very weak base from which to look for changes in trend. Investment in developing countries has mainly occurred to exploit natural resources or to supply rapidly growing local markets. In some cases, investment to supply industrial country markets has also been encouraged by special advantages: in labour costs, or more recently in capital (through debt-equity swaps), or in advantageous access to markets other than those of the investor through trade preferences.

Commodity prices are not expected to be attractive, although some new opportunities, and some capacity shortages, will be available. After growing at twice the rate of industrial countries in the 1970s, developing countries' economies slowed down in the 1980s. Even with some recovery, they are expected to grow over the first years of the 1990s only by 4.5-5% compared with 2.5-3% in the industrial countries (forecasts summarised in Page, 1990a), and any increase in EC growth because of 1992 would further narrow their advantage. A significant differential in their favour is needed because of their 'normal' difficulties of poor physical and human infrastructure, inexperienced administration, etc. Those countries with heavy debts offer particular obstacles, including low availability of foreign exchange and lack of confidence in policy.

Labour costs have been rising faster in the traditional Asian recipients of foreign investment, Malaysia and Singapore, than in the Community. The importance of large supplies of cheap labour may also be falling. It was characteristic of a particular type of production in the electrical and electronics industries (and more traditionally, but on a smaller scale, the textiles and clothing industries). The textiles and electronics industries are both becoming more capital-intensive. (Clothing could move the same way, and is certainly more sensitive to close contacts with markets.) Whether whatever similarly successful industry (goods or service) in the coming decade also turns out to be intensive in a factor existing in developing countries will have a strong influence on their being able to keep their share of world investment. As with low-cost labour, which was characteristic of the Asian NICs but much less common in Africa or Latin America, any such particular advantage would help only certain countries.

The international institutions expect a levelling off in the use of debt-equity swaps (International Finance Corporation, 1989). There may be some increase in the use of broader conversion funds (similar but on a portfolio investment basis), but their total investment so far is only $0.01 bn. The increased freeing of capital movements in developing countries could encourage a portfolio adjustment from them to the industrial countries; this, combined with continuing high interest (and profit) rates in the industrial countries, would raise the relative cost of capital in developing countries. One force in the opposite direction is investment from Hong Kong.

There are no indications that preferential market access will be increased (certainly not by enough to counter the much greater preference for EC traders). But if the renegotiation of the MFA in 1990-91 leads to a reduction in restrictions, and ultimately to a return of textiles and clothing trade to the GATT (Page, 1990b), or if there are other substantial reductions in non-tariff barriers to developing country exports in the Uruguay Round, there could be a step adjustment of investment in their favour. Textiles and agriculture, however, are low-growth, low income-elasticity industries.

One factor in the opposite direction is the shift, particularly in some Latin American and African countries, towards a more favourable view of the potential effects of foreign investment. This has influenced the actual cost of investing, through tax, foreign exchange, or other concessions, and perhaps also the expectations of foreign investors. Encouragement by the multilateral agencies, which reached a peak of enthusiasm in the mid 1980s, does not seem to have had a significant effect.

There are effects which could lead to diversion to the developing countries. In the past, US and Japanese firms have been more willing than European firms to invest abroad in order to cut costs, as well as for the traditional motives of supplying local markets or obtaining raw materials. Two possible explanations for this (Page, 1987) are that they are more accustomed to managing decentralised production because of a base in a large home market or that the cost advantages were much greater because of the high value of the dollar (in the 1970s) and the yen (in the second half of the 1980s) and the level of incomes in the United States and Japan. If there is a substantial move to large-scale production or a large gain in income in the Single European Market, these could lead to a greater European willingness to look for opportunities to invest abroad, including in the developing countries. Such a shift would have a disproportionate benefit for the countries in which member states' investment has concentrated in the past, because of the tendency of foreign investors to be conservative in their destinations, thus helping Africa.

A shift in aggregate foreign investment from developing to developed countries began for the United States in the 1950s and for the United Kingdom in the 1970s. For Japan, it did not start until the early 1980s (Page, 1987). Levels for other EC member states were already low: by the early 1980s the share of developing countries in French and German foreign investment was between 10% and 20% and smaller for other EC members. These low levels, and the timing of the UK shift, are perhaps attributable to the Community. French and UK investments were relatively concentrated in their traditional partners in Africa. The Japanese shift was initially to the United States, but more recently to the Community: the long-term strategic approach of Japanese investors suggests that both these moves could be the result of expectations of greater protection of domestic markets, including the *de facto* advantages to be gained within the Community from the Single European Market even if there is no 'Fortress Europe'.

The data (estimates) indicate a sharp fall in total foreign investment in developing countries in 1983 and thereafter (from nearly $20 bn to some $13 bn in 1983 and less than $10 bn in 1986). Obviously the fall was considerably greater in real terms. Since 1987 there has been some recovery, with direct foreign investment in the these countries reaching $14 bn in 1988 (IMF, 1990). The IMF interpretation suggests that the 1987 rise was entirely attributable to an increase in Asia (principally from Japan) and the 1988 rise was to Latin America (in the form of debt-equity swaps), and was net of a fall-back for Asia. The international institutions assume in their forecasts that both of these were short-term events (the former a response to the revaluation of the yen), and not signs of a new path. The simultaneous, strong, and very general rise in investment in the industrial countries could suggest that more permanent factors were at work. While there is some evidence that the increase to the Asian NICs levelled off in 1988 (although a large fall looks unlikely), unofficial estimates suggest strong rises in both 1987 and 1988 in Malaysia, Thailand, and Indonesia (*South*, 1989), with future growth possible in India (cited in International Finance Corporation (1989) as a 1988 recipient) and other Asian countries. World Bank data on total investment ratios to GDP also suggest a more sustained recovery. Japanese outflows appear to remain strong, and regulation of Japanese bank participation in swaps has recently been relaxed.

The 1989 OECD study throws doubt on the developmental significance of the recovery in direct investment flows after 1985. When the increases in flows to the Asian NICs are excluded, the increase can to a large extent be attributed to intra-company financial transactions resulting in apparent flows to Bermuda, the Netherlands Antilles and Hong Kong, and to investment in Japanese off-shore banking business in South America and shipping business in Panama.

The most important effects attributable to 1992 will probably be the negative ones from new opportunities, real and perceived, in the Community. Studies of foreign (or other) investment all find that such stimuli are the principal influences, along with general economic prospects, and not active policy intervention (if only because policies which can be introduced can also be changed). Neither the Community nor the developing countries offer particularly good growth possibilities, relative to other areas of the world. Although all investors will be potentially diverted from the developing countries to the Community, it seems plausible that the largest effects, in both costs and perceptions, will be on EC investors. As the most important investors in the developing countries in recent years have been the United States and Japan, this means that the impact may be muted. But this factor could be outweighed by the greater responsiveness of US and Japanese investors to new opportunities (which is one possible explanation of their greater presence in these countries). In spite of the large and geographically general rise in investment flows in the last years, forecasts for future levels of investment are very pessimistic. Even if there are large 1992 diversionary effects, investment in Asian and perhaps some Latin American countries could be higher than currently forecast.

Table 6.1 presents the available evidence on the geographical distribution of US, German, UK and Japanese direct foreign investment over the period 1981-88. Data for investment in Spain and Portugal are also included since it can be argued that there were strong and independent incentives to invest in these countries either prior to or soon after they entered the Community.

Taking the data together there is no clear evidence of a diversion of investment from the developing countries in favour of the Community. Foreign investment figures are subject to considerable uncertainty and data problems may give an impression of even greater volatility than is inherent in the flows themselves. However, there is no doubt that the actual flows fluctuate considerably from

Table 6.1
Direct investment flows from certain OECD countries[a], 1982-88 ($ bn)

	1982	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*
United States							
Total	4.3	1.7	3.3	12.6	15.4	29.8	17.5
Developed	-0.7	1.0	1.1	12.1	14.7	27.4	5.5
EC(12)[b]	0.8	-1.2	-0.1	10.9	9.2	16.3	1.3
Spain and Portugal[b]	0.1	-0.2	-0.1	0.4	0.4	1.1	0.5
Developing	4.9	0.6	2.9	0.1	1.7	2.2	3.8
Germany[c]							
Total	51.3	53.3	57.9	50.6	70.1	86.7	104.2
Developed	38.9	41.1	45.5	40.6	57.9	72.7	87.2
EC(12)	16.9	17.1	18.7	17.4	26.7	34.0	41.0
Spain and Portugal	1.8	1.8	2.0	1.8	3.2	4.3	5.6
Developing	9.2	9.0	10.0	7.3	9.1	10.7	12.8
United Kingdom							
Total	3.7	5.3	7.8	11.1	17.3	31.1	36.6
Developed	3.6	3.8	5.3	8.1	15.4	28.0	32.9
EC(12)		-0.1	-0.3	3.1	3.3	3.5	9.3
Spain and Portugal	0.1	0.1	0.1	0.4	0.3	0.6	1.1
Developing	0.2	1.5	2.4	2.1	1.9	3.1	3.5
Japan							
Total[d]	7.7	8.1	10.2	12.2	22.3	33.4	47.0
EC[e]	0.8	0.9	1.9	1.9	3.4	6.3	8.3
Spain		0.1	0.1	0.1	0.1	0.3	0.2
Developing	3.5	4.3	4.6	4.3	7.4	10.1	13.0

Notes

a. net of repatriated earnings; excluding finance except banking, insurance and real estate. Investment in developed countries and developing countries does not sum to total because of investment not allocable to individual countries (negative in 1984, 1986 and 1988).
b. data for Spain and Portugal gross of financial investment.
c. developed and developing do not sum to 100% because of investment in state trading nations, and investments not allocable to individual countries.
d. based on change in direct investment position. Includes reinvested earnings. For details see OECD, 1989, p. 63, notes.
e. Belgium, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Spain, United Kingdom.

Sources: *Survey of Current Business*, US Dept. of Commerce, August, various years; *Statistical Supplement to Monthly Reports of the Deutsche Bundesbank*, Series 3, April 1990, No. 4; *Business Monitor*, UK Department of Trade and Industry/Government Statistical Service, various years; *Financial Statistics of Japan*, Ministry of Finance, various years.

year to year, partly in response to changes in the political and economic environment, but also because of the variability of profits and retained earnings and of the valuation effects of exchange rate changes. It is still too early to conclude from these data whether or not there has been significant diversion because of the run-up to 1992.

Nevertheless there are hints of a 1992 effect in several of the series. There was a step increase in US investment in the Community around 1985, which can only partly be explained by investment in the new entrants, Spain and Portugal. The higher level of investment faltered in 1988 though it is too early to determine whether that was one-off or the start of a new pattern. In the German data there seems to be a trend in favour of increasing the EC share in direct foreign investment. To some extent this can be attributed to increased investment in the two new member states. But when the figures for Spain and Portugal are subtracted from those for the Community as a whole, there seems, as in the US case, to have been a step increase in 1985. This pattern is much more accentuated in the UK data. Ignoring 1982, when the figures were distorted by nationalisations in Malaysia, this major increase in the Community's share is clearly at the expense of the developing countries though it cannot be inferred that the absolute amount going to the developing countries was depressed by the increased incentive to invest in the Community. In the case of Japan the share of the developing countries in foreign investment has fallen steadily since 1982 while that of the EC has risen.

A lot more work needs to be done to identify the new-entrant and 1992 effects of direct foreign investment. It will probably have to start from a microeconomic approach, analysing the investment decisions of individual firms. The evidence to date does not exclude a 1992 effect on the flows of private investment. New data when they become available may reinforce the suggestion that diversion towards Europe has taken place. But aggregate data, given that they comprise a large number of financial flows with very different motivations and critically affected by 'acts of God' or at least of foreign governments, will never do more than suggest the existence of some causal factor.

Notes

1. According to the Padoa-Schioppa report (1986, p.35), '[s]tudies of price differences between countries of the Community for products bought by government suggest that economies of the order of 25 percent are often foregone in not buying at the lowest costs offered on the competitive markets'. The procurement study (Commission, 1988b), which was prepared as background to the Cecchini Report, suggests that savings of 4% in construction and over 7% in manufactured goods are available to member state governments through a liberalisation of public procurement rules. One would expect the gains to the developing countries to be even higher, because (i) a greater share of procurement in the donor country is generally required than that required by member state procurement regulations, and (ii) there are no significant extra costs such as transport, insurance or exchange rate cover, which a member state government would have to meet when procuring in another member state.

7
Impact of the SEM on Specific Developing Countries

This chapter takes a closer look at a few selected countries — Morocco, Tunisia, Côte d'Ivoire, Kenya, Zimbabwe, St Lucia and St Vincent, Malaysia and Thailand — and the likely impact of the 1992 programme on their trade with the Community. Emphasis is placed on merchandise trade because, for most developing countries, it is through that channel that the most important effects of the SEM will work.

However, first a word about tourism, since the most important effect on trade in services will be the stimulation of tourism. Malaysia and Thailand have successfully developed their tourist sectors and they will continue to expand in this direction. The income effects of the 1992 programme may induce more Europeans to take far-flung vacations in these countries but their tourist receipts are still small relative to merchandise exports. The value of Thai earnings on tourism in 1987 were Baht 40.2 bn compared with total exports of Baht 299.9 bn and exports of textiles of Baht 48.5 bn. Separate data on tourism exports to the Community are not available. The relative contribution of tourism earnings in Malaysia is considerably smaller.

For St Lucia and St Vincent tourism is the only major alternative in terms of value added and employment to their banana monoculture which will probably be devastated by the introduction of a SEM in bananas, even if steps are taken to preserve their access. Chapter 5 noted the controversy surrounding the promotion of tourism as an alternative to merchandise exports.

This chapter does not consider aid or investment. In the case of aid, 1992 may lead towards tying procurement to the Community rather than to the member state donor country. This will probably take some time, and in any event there is little reason to expect the benefits, as a proportion of the level of member state bilateral aid, to differ widely between recipient countries. Total OECD foreign direct investment in the developing countries in 1987 is estimated at $13.2 bn or 11.5 bn ecu. We argued in the previous chapter that it is impossible to estimate with any confidence how much investment could be diverted by the SEM from the developing countries to the Community. There could be some flow back to the developing countries in response to higher total investment by EC enterprises. In any event, net diversion of direct foreign investment is most unlikely to approach our estimate of overall trade creation of 7.3 bn ecu or trade diversion of 4.7 bn ecu (though it could be in the region of the difference between the two).

Morocco and Tunisia

These two countries are discussed together since they have similar co-operation agreements with the Community, they tend to share the same comparative advantages and they export a similar mix of goods to the Community. In 1987 Morocco and Tunisia exported merchandise worth 1.9 bn ecu and 1.5 bn ecu respectively to the EC. Of this 46% and 35% respectively were agricultural and other primary goods, of which fresh or chilled fish, fruit (in particular citrus), vegetables, and minerals, in particular phosphates, were the principal headings. Clothing accounted for more than half of manufacturing exports in both cases, with chemicals 14-15%. Textile yarn exports made up 11% for Morocco and 6% for Tunisia, with machinery and transport equipment 7 and 9% respectively. In each case petroleum products accounted for some 5% of manufactured exports. Processed food, largely canned fish, accounted for 13% of Morocco's manufactured exports but next to nothing for Tunisia.

Horticultural and fish exports: The Maghreb countries are treated relatively generously by the Community as regards their exports which are subject to a CAP regime. On goods such as citrus fruits, tomatoes, olive oil and wine there are substantial tariff concessions of up to 100% depending on the good and the season (though some are limited by tariff quotas). However, the Maghreb exporters are less concerned about the height of the tariff wall than the reference (or effectively minimum import) price system which largely prevents them from competing with EC producers. In particular Morocco has protested regularly over the reference price for tomatoes — with some success. The Community has introduced the 'entry price modulation' system for citrus fruit, tomatoes and cucumbers, which allows for a reduction in the minimum entry price initially up to the tariff and then by decreasing percentages. This represents a small but effective reduction in EC protection.

By and large the Maghreb countries, which are not restricted under the French QRs, appear to benefit from the national QRs taken as a whole. They are denied export markets for tomatoes in BLEU and tomatoes and orange juice in Greece. On the other hand, they export considerably more of a number of products to France than might have been expected: beans (not listed in Table 3.2, since the total level of exports is below the threshold), new potatoes and orange juice.

The elimination of QRs will mean that in a number of goods Morocco will be faced with increased competition in the SEM, ironically in many cases from ACP states in sub-Saharan Africa. In other, but less critical, cases it will have access to markets that have hitherto been closed. But the most important issue as regards access to the EC market in fruit and vegetables is tied up with the future of the CAP. As long as access depends on political concession, whether by France or the Community as a whole, the Maghreb countries will not be able to exploit their comparative advantages fully in this sector.

France has national quotas on canned sardines, tuna and black skipjack (aka 'euthynnus' in, and only in, the trade statistics). In the case of sardines the QR seems unnecessary. Morocco is the only exporter to the Community and France has given Morocco immunity from the QR. The new regulations on fish health and hygiene may be a problem in the case of Morocco, and new investment may be required in some of the older processing plants.

Textiles and clothing: Morocco exported textiles worth 110 m. ecu and clothing worth 541 m. ecu to the Community in 1987. For Tunisia the respective figures were 62 m. and 560 m. ecu. Textiles and clothing represented 34% and 40% of Moroccan and Tunisian exports to the Community in that year. Thus the outlook for textile and clothing exports is crucial to these countries.

Even though their exports to the Community are not subject to MFA quotas, the future of the MFA is still of significance to them. Erzan et al. (1990) suggest that the Mediterranean countries' exports may have gained from the EC MFA restrictions as a whole. To the extent that these restrictions are marginally eased through dropping the member country shares, these suppliers may stand to lose somewhat. In some cases the Maghreb states will have to work hard to maintain their existing market shares.

The EC has forced the Maghreb countries to accept VRAs on their clothing exports. In general they have been treated rather better than the MFA suppliers — with greater flexibility to borrow from next year to this (and carry forward into the next year) and generally higher annual growth rates. If the MFA is phased out and imports of clothing and textiles from countries currently under the MFA are allowed to compete subject only to tariff discrimination, there will clearly be demands from the Mediterranean countries that they too should be freed from any quantitative controls.

The EC-wide VRAs will not be affected directly by 1992, but in some cases there are VRAs limited to particular member states. 'Thus Morocco's trouser exports have been restricted throughout the Community, whereas those of shirts, blouses, dresses and anoraks were restricted only in France and the Benelux countries' (Economist Intelligence Unit 1988, pp.73-4). After 1992 these member state VRAs should disappear as they are not compatible with free circulation of goods in the Community. However, it may not be possible to eliminate them all, particularly as they can be maintained without official approval or even knowledge. If intra-EC border controls are in fact abolished, these VRAs will become much more difficult to monitor. It is important for the exporting countries that they are not replaced by EC-wide restraints which would represent a considerable increase in Community protection.

While exports of textiles and clothing from the Maghreb have little to gain or lose from the 1992 programme, they would be at risk from increased competition from lower-cost producers if the MFA were significantly liberalised. On the other hand, they could expect to have some relaxation of their quantitative restraints.

Oil refining: Exports of oil products to the Community in 1987 amounted to 55 m. ecu for Morocco and 48 m. for Tunisia. The 1992 programme comes at a time when there is considerable concern within the Community about excess capacity in the refining sector. Between 1973 and 1985 the amount of oil refined in the Community dropped by 34% (Economist Intelligence Unit, 1988). Over the same period the Community shifted from being a net exporter to being a net importer. The SEM itself will not change this picture. There are no large unexploited economies of scale.

However, there are opportunities for rationalisation that are not included in the estimates of the 'trade diversion elasticity' in Table 2.1. These stem from the government intervention in marketing in France, Italy and Spain, the countries which import most of the refined products from the Maghreb. In Spain, where government controls are greatest, the retail petrol market is closed to foreign companies. In France and Italy foreign participation is restricted. As these non-tariff barriers fall, these countries will become part of the internationally integrated business 'festooned with logistically driven cross-border refining and distribution agreements' (UBS-Phillips and Drew, 1988, p.75). While imports from the Maghreb and ACP states might continue to enjoy preferential treatment, they could suffer from the cost reductions associated with integrating France, Italy and Spain into the international network.

General trade effects: It has been calculated that Morocco will gain from trade creation in primary goods by some 24 m. ecu or 3.1% of exports, while Tunisia will gain by 26 m. ecu or 5% of exports. The difference is due to Tunisia's crude oil exports, for which the income elasticity of demand is greater than for most other primary goods. Morocco only exports refined oil and oil products to the Community; these are treated as manufactures.

In the case of Morocco the primary sector which contributes most to trade creation is minerals, including fertilisers, and in particular phosphates. Morocco is the world's largest exporter of phosphate rock, with the Community taking some half of its exports. However, Morocco is steadily increasing the proportion of phosphate which it processes into acid and fertilisers, though these have largely been exported to the developing countries and the Soviet Union rather than to the Community (Economist Intelligence Unit, 1988, pp.67-8).

As for manufactured exports, Morocco and Tunisia are each estimated to benefit from trade creation of somewhat under 100 m. ecu each and diversion of somewhat more than 100 m. ecu. Trade creation mainly comes from chemicals and clothing and textiles. The two sectors where trade diversion in favour of EC producers is likely to be most serious are chemicals (including processed fertilisers) and machinery and transport equipment. According to the Commission's studies for the Cecchini report (Cawley and Davenport, 1988), even before the dynamic effects — economies of scale and other efficiency gains from rationalisation of production — are taken into consideration, the Commission expects the cost savings from eliminating barriers within the Community to result in a reduction in EC imports from third countries of around 12%. The economies of scale effects are also expected to be substantial. Trade diversion is a threat to Morocco's plans to increase exports of phosphatic fertilisers to the Community (*ibid.*, p. 88). Morocco currently enjoys a cost advantage though this could be eroded through 1992-led restructuring in the EC fertiliser sector.

Côte d'Ivoire

A decade ago Côte d'Ivoire was trumpeted as the great sub-Saharan success story, the 'Ivoirian miracle'. Rapid growth from the late 1960s to the early 1970s was led by a growth rate of manufacturing output of more than 9%. The 1970s were characterised by sharp recession and a short-lived but vigorous recovery. By 1980 exports accounted for a remarkable 35-40% of manufacturing output (Riddell, 1990b, p.152). However, the miracle was not to last. In the period 1980-88, GDP growth was negative while value added in the manufacturing sector fluctuated wildly but on balance has scarcely risen. Meanwhile manufacturing exports contracted.

Nevertheless, the years of rapid growth and industrialisation have left Côte d'Ivoire with a more diversified pattern of exports to the Community than any other sub-Saharan country. Major exports include fresh fish (18 m. ecu in 1987), bananas (51 m.), pineapples (111 m.), cocoa (634 m.), coffee (268 m.), wood (232 m.) and diamonds (49 m.) out of a total of 1,749 m. ecu. However, manufactures now account for only 194 m. ecu. Of these canned tuna (68 m.), textile yarn (23 m.), wooden articles (29 m.) and clothing (8 m.) are the most important.

Over the 1980s Côte d'Ivoire has become more rather than less dependent on exports of agricultural commodities, in particular, cocoa, coffee and wood. With the prospects for prices of most commodities generally poor, any increase in earnings which might come about through the 1992 programme would be a positive element in an otherwise bleak outlook.[1]

Fruit, fish and tropical beverage exports: As pointed out in Chapter 3, the seriousness of the problem of the Community and ACP banana producers, faced with a more competitive EC market, varies among the producing countries. Productivity in Côte d'Ivoire, at 21 tonnes per hectare, is relatively high.

According to the model used in Chapter 3 and with 1988 trade as a basis, a free market would result in an annual loss in exports of 34,000 tonnes (45%) and export earnings of 28 m. ecu (59%). Clearly this would be a major blow. If a deficiency payments system were adopted with a common guaranteed price of 50 ecu/100 kg for ACP producers, Côte d'Ivoire exports to the EC would fall by 26,000 tonnes (34%) and export earnings by 22 m. ecu (47%) — a slightly better outcome. Finally a quota on dollar bananas equal to 1988 export volumes, with the 20% tariff continued (and extended to all German imports), would leave Côte d'Ivoire almost unaffected. Export tonnage and revenues would both rise slightly (by 1 and 2% respectively).

Pineapple exports are currently privileged under France's system of QRs. Côte d'Ivoire supplies half of France's consumption, the balance coming from the overseas territories. In 1988 the trade was worth some 90 m. ecu to Côte d'Ivoire. Following the abolition of member state QRs, Kenya, with an ACP tariff preference of 9% (like Côte d'Ivoire), and Costa Rica, faced with mfn tariffs, are likely to be the principal competitors.

Fish have played an increasingly important role in Côte d'Ivoire's exports to the Community. Both for fresh and canned fish, there could be problems with the new health and hygiene regulations, as regards bacterial contamination of inshore waters or standards of hygiene in processing plants. At the least, the new regulations are going to prove costly in terms of prescribed bureaucratic procedures. Clearly too, even in the event of full compliance to all standards and procedures, there are dangers of delays at EC entry points and harassment by inspectors and customs officials, which could be expensive where fresh fish is concerned. Another problem will be the loss of privileged access to the French market when the member state QRs are finally abolished. This could hurt Ivoirian exports of canned tuna.

Tropical beverages: If excise taxes on cocoa (and cocoa products) were eliminated and a 5% rate of Value Added Tax imposed throughout the Community, Côte d'Ivoire would stand to gain from rises in EC imports of some 11 m. ecu (made up of a 1.8% price increase and a 1.4% volume increase). There would a further gain of 6.9 m. ecu in additional export earnings from other importers as world prices rose (and volumes of imports fell, but less so). The earnings gains on coffee would amount to some 34 m. ecu on exports to the Community and 13 m. on exports to the rest of the world. Although coffee exports are less than cocoa exports, excise taxes on coffee are much higher in Germany and the effects of elimination of excise taxes considerably greater.

General trade effects: The estimates of trade creation in primary goods give a total of 41 m. ecu or 2.7% of exports of primary goods. Of this, 13 m. and 9 m. ecu respectively derive from increased exports of cocoa beans and wood. Trade creation in manufactures is estimated at 12 m. ecu, or 9.3%. Of this total 8 m. ecu comes from 'manufactures classified by material', including processed wood, wooden articles and paper pulp. Trade diversion in manufactures is estimated to exceed creation, largely because of diversion in wood processing. Côte d'Ivoire exports significant quantities of semi-processed products — wooden panels, plywood, veneers and similar products — where there is likely to be more acute competition in the EC market, particularly from French firms. The Commission studies foresee a reduction of wood products imports of 5.5% - 7.5% owing to direct cost savings from market integration (Cawley and Davenport, 1988).

Kenya

Of Kenya's total exports to the Community, valued at some 498 m. ecu in 1987, tropical beverages account for the larger part (coffee: 155 m. ecu, tea: 123 m. ecu), while most of the balance consists of leather (36 m. ecu), vegetables (24 m. ecu) and flowers (23 m. ecu). Manufactured exports amounted to only 53 m. ecu and of this 33 m. ecu were made up of preserved fruits, mainly canned pineapple, and another 5 m. ecu by footwear.

Kenya still largely depends for foreign-exchange earnings on its traditional export sectors, coffee, tea and pineapples, though vegetables and flower exports to the Community have shown considerable growth in recent years. Manufactured exports remain small and 91% go to other developing countries, mostly in sub-Saharan Africa (Sharpley and Lewis, 1990, p.206). Indeed, manufacturing value added is, at 13%, a much smaller share of GDP than in, say, Zimbabwe, though slightly larger than the sub-Saharan average (10%). Also, however, the share of exports in manufacturing output has declined dramatically from 40% in 1964 to 10% in 1984.

Industry in Kenya has grown increasingly inward-looking (*ibid.*, p.238). Rates of protection have increased — at the expense of agriculture and tourism — and there has been discrimination against exports of manufactures. Misguided trade policy has led to a vast debt burden of some $4 bn and a debt-service ratio of 36-39% (Coughlin, 1990, p. 250). In this parlous economic situation any help from the SEM to exports, particularly of manufactures or non-traditional agricultural goods, would be valuable in reducing dependence on the traditional export crops.

Horticultural and tropical beverage exports: In recent years Kenya has rapidly built up a major export trade in flowers. Chapter 4 described the problems that are likely to arise with the tighter monitoring of phyto-sanitary regulations.

Kenya capriciously appears to benefit from French QRs on beans and suffer from French QRs on pineapples. In general, 1992 will give a boost to the trend (associated with the restructuring of the retail food trade in Europe) towards stiffer competition in the market for off-season vegetables and fruit in the Community. More Northern and sub-Saharan African and Central American countries are already entering this market. Whether Kenya will benefit depends primarily on its ability to keep costs down and quality up, and to guarantee reliable deliveries.

Eliminating excise taxes on tropical beverages in the Community and standardising VAT should increase Kenya's exports of coffee by some 15% (or 15 m. ecu) and of tea by 1.4% (or 2 m. ecu). These figures include both the price and volume increases to the EC market, and the price increase (and volume decrease) on exports to the rest of the world.

Footwear: Kenya's small footwear sector would gain from a tough EC protectionist policy either against all developing countries' exports, since it is unlikely that the ACP states would have their access controlled, or one specifically directed against the producers in East and South-East Asia.

General trade effects: The only significant sources of trade creation in primary goods are likely to be coffee and tea, which together are estimated to yield 6 m. of the 9 m. ecu of trade creation. This might be something of an underestimate since Kenya has taken to specialising in out-of-season vegetables (like green beans) and 'exotic' fruit and vegetables, including passion fruit, avocados and cherry tomatoes. The income elasticity of demand for these goods is probably somewhat higher than that for fruit and vegetables as a whole.

Trade creation in manufacturing is estimated at 5 m. ecu or 9.6% of manufacturing exports to the Community — of which sisal, pyrethrum and rotenone are significant components. These are all subject to competition from synthetics, and trade diversion is in fact estimated at 7 m. ecu.

Zimbabwe

In 1987 Zimbabwe exported merchandise worth 474 m. ecu to the Community of which primary goods accounted for two-thirds. Tobacco exports alone came to 134 m. ecu, sugar 28 m., nickel 24

m. and copper 21 m. ecu. Among manufactured exports the most important were ferro-alloys (53 m. ecu) and meat products (35 m. ecu).

Riddell sees Zimbabwe in the future as possibly the first of the sub-Saharan NICs (1990a, p.337). Manufacturing accounted for 26% of GDP in 1988 though three sectors, foodstuffs, chemicals and metal products accounted for more than half of gross manufacturing output, value added, employment, capital stock and exports. In real terms manufacturing exports have declined in the 1980s — at an average annual rate of 3.2% between 1980 and 1986 — while value added in manufacturing has continued to grow but at a slower pace than that of GDP (2.4 against 3.1% over the same period) (Riddell, 1990a, p.378). It is hardly likely that Zimbabwe can regain the earlier momentum towards industrialisation without strong growth in manufacturing exports and further diversification. The significance of the SEM depends largely on whether it will be a positive factor in reaching these goals.

Food and tobacco: Various aspects of the new body of EC food law could be of significance to the meat product industry. In particular, the new meat product proposal tightens up the requirements for imports of canned meat to the Community and more investment will be required to get a Zimbabwe processing plant to an acceptable standard.

While the member states are likely to agree to move very gradually to an agreed band for excise taxes on tobacco, it is now far from clear when that might be accomplished or at what level. A plausible hypothesis was adopted in Chapter 4, namely that tax rates would ultimately be aligned on the average of the four states with the highest present excise rates, leading to an eventual reduction in tobacco imports of 10-15%. If that were to be spread evenly among exporting countries, based on 1987 trade and prices, Zimbabwe would face a serious loss in export earnings, of 18 m. ecu or 14% of the value of its tobacco exports to the Community. This would be partially compensated by the rise in exports to other countries in response to the fall in world tobacco prices. The net effect would be a fall in tobacco exports of somewhat less than 12 m. ecu.

Of course, this assumes unchanged market shares. The trend towards lighter, low-tar and low-nicotine cigarettes has been speeded by Community legislation (which is also a 1992 effect). If Zimbabwe tobacco growers can adjust to these changes in the pattern of demand for different varieties, they may be able to increase their market share.

Much more significant would be any move, perhaps related to the Uruguay Round negotiations on agriculture, to reduce the protection of EC tobacco farmers. At present the Community produces low quality 'oriental' tobaccos, which are not much in demand in the EC and are exported, mainly to the Middle East, with the help of 'restitution payments' (Davenport, 1988). The Community then imports higher quality varieties, mainly from the United States, Zimbabwe, Malawi and Brazil, with tariffs on non-ACP imports of roughly 7%. If this regime were phased out, the world price of all varieties would tend to rise with the end of EC 'dumping' of oriental tobacco on the world market.

General trade effects: Trade creation is calculated at only 9 m. ecu, of which 5 m. is attributable to tobacco. Owing to exports of ferro-alloys and other steel products, Zimbabwe could experience significant trade creation in manufactures (estimated at 14 m. ecu or 9.3% of exports to the Community). However, the continued rationalisation in the EC steel industry could result in a negative balance — trade diversion exceeds trade creation in the sector 'manufactures classified by materials'. Zimbabwe is a major importer of machinery and transport equipment from the Community and most of the import bill savings from lower EC export prices fall within this class.

St Lucia and St Vincent

Both these small island economies are totally dependent on exports of bananas. St Lucia exported goods worth 87 m. ecu to the Community in 1987, of which bananas accounted for 85 m. ecu. In the case of St Vincent the respective numbers were 39 and 37 m. ecu. Unfortunately, along with the French overseas departments, Martinique and Guadeloupe, they are the highest-cost of all the suppliers to the Community, largely because the industry consists of smallholdings which are topographically unsuited for plantation techniques.

The general problems in devising a new banana regime have been discussed in Chapter 3. All of the alternative trade regimes would have dramatic implications for St Lucia and St Vincent. In a free market (with a 14% EC tariff on dollar bananas) they lose about 55% of their export volume and 70% of their export earnings. Under the most generous deficiency payments scheme the figures are 60 and

75% respectively, and under a quota on dollar bananas (plus the 14% tariff), 25 and 35%. Even under a mixed deficiency payments/quota system where guaranteed prices were set at 70 ecu/100 kg, which would be very costly to the Community budget, they would lose some 15% in the volume of exports and over 20% in value.

None of these outcomes could be accepted without major economic restructuring. The problem is finding some alternative activities for the small-scale independent farmers. No doubt, whichever trade regime is adopted, the Community will make funds available for diversification. But unless an alternative staple crop, or number of crops, is found through which the existing smallholdings system can survive, there is a serious danger of a major political and social upheaval.

Sri Lanka

Sri Lanka's principal exports to the Community are coffee and tea. Together they made up 43% of primary goods exports in 1987 and 18% of total exports. Fruit and nuts at 16% and crude rubber at 15% are the other significant primary exports. Among manufacturing, clothing and textiles are dominant and in 1987 made up 42% of total exports. Up to 1986, taking exports as a whole, tea was more important than clothing and textiles.

The Sri Lankan economy is currently undergoing a period of rapid growth, though a recent resurgence of civil strife threatens that progress. In the past civil disturbances have resulted in major losses of output. In 1989 output of both tea and rubber fell some 10% directly because of the disturbances. One important contributing factor to the improved economic prospects is the strong flows of direct foreign investment from Taiwan and South Korea, though they too are put in jeopardy by renewed hostilities.

> ...[T]he longer term economic potential of the economy is enormous. If a sufficient degree of peace were to be achieved and held for sufficiently long and if government economic policy continued to reflect its generally prudent current stance, the Sri Lankan economy could grow very fast and the resulting increase in prosperity begin to chip away at the underlying discontent which afflicts so much of the island. (Economist Intelligence Unit, 1990, p.4)

Though tea prices have recently improved, the commodity terms of trade continue to move against Sri Lanka. The share of manufactures in exports is growing rapidly, up from 39.5% in 1985 to 50.7% in 1989. Of these clothing and textiles are the most important — now constituting 31.4% of total exports while cut diamonds have recently shown remarkable growth rates.

Tropical beverages: The effects of harmonising taxes on coffee and tea would be a rise in the value of total exports of 0.6 m. ecu for each. These figures include both increased exports to the Community and the effects of higher world prices, consequent on eliminating excise taxes in the EC.

Textiles and clothing: According to the estimates of the effects of eliminating member state subquotas on MFA products presented in Chapter 3, Sri Lanka will be the principal gainer. Taking the average of the estimates, exports of MFA products could rise by about 8%, or on the basis of 1987 data by some 11 m. ecu.[2] The future of the EC MFA as a whole is more crucial to Sri Lanka than the abolition of member state subquotas. If the MFA were to be phased out, Sri Lanka with its labour cost advantages and a well-established and flourishing industry should benefit disproportionately.

General trade effects: Mainly because of the concentration on exports of tea, with its low income elasticity of demand, trade creation in primary goods is estimated at only 4 m. ecu or 3% of exports to the Community. However, in manufactures the calculations give trade creation of 18 m. ecu and diversion of 16 m. ecu. Clothing is the principal component in both cases.

Malaysia

Because of their outward-looking trade strategies, pragmatic exchange rate policies and rapid expansion of exports, the ASEAN countries are often considered to be among the new NICs. Among the ASEAN countries, Malaysia and Thailand in particular are contenders for the title. Industrialisation has taken off in both countries, with trade in manufactures growing rapidly. The share of the manufacturing sector rose from about one sixth to one quarter of GDP between 1975 and 1988. Moreover, they have adopted and persisted in a policy of openness, as regards both their welcome for foreign direct investment and liberal access to their markets.

Despite a clutch of institutional arrangements to foster good relations, the ASEAN countries bear a long-standing grudge against the Community, feeling that their exports, in particular, are unfairly treated. First, they do not enjoy the same tariff preferences as the ACP states. Secondly, the Generalised System of Preferences, which is supposed to benefit them, is so hedged around with rules of origin, tariff quotas, bureaucratic hurdles and other restrictions that it appears to yield very little in terms of advantageous access to the EC market. Thirdly, whenever they seem to find a new product for which there is strong demand in the EC market, they are hit with barriers, often of doubtful legality under the GATT. These include voluntary export restraints on Thai manioc, reduced quotas under the EC MFA and new tariff quotas under the GSP, and several anti-dumping cases.

By and large, the 1992 programme will make less of an obvious impact on the long-term trade relations between the ASEAN countries and the Community than will the Uruguay Round in its repercussions for the future of both the MFA and the CAP. Nevertheless, the 1992 programme may be of considerable significance in making the Community more competitive in, say, producing synthetic rubber. In addition, the exports of the ASEAN countries are vulnerable to new EC regulations on fish health and hygiene. Thirdly, they may be justifiably concerned that, if there were to be a wave of 1992-generated neo-protectionism in the Community, they will suffer disproportionately because of the mix of their exports.

Malaysia has diversified out of its traditional commodity exports — rubber, tin, tropical woods and palm nuts and unrefined palm oil — into mineral oil and oil products, coffee, and cocoa and a range of manufactures including yarns, textiles, clothing and electronic components. Four difficult years, when commodity price fluctuations resulted in massive swings in export earnings and successive balance of payments and bankruptcy crises, were followed by three years of recession from 1986 to 1989. Now that a large measure of restructuring has taken place the economy is much less vulnerable to price weakness in individual commodities, though a generalised weakness across different commodities, such as would occur in a world-wide recession, would create major difficulties.

Malaysia's exports to the Community reflect this diversification. In commodities, rubber (430 m. ecu in 1987), palm and palm kernel oil (203 m. ecu) and cocoa (69 m. ecu) are still dominant among primary goods but coffee (21 m. ecu) is becoming increasingly important. Exports of manufactures in value (1042 m. ecu in 1987) now almost equal those of primary goods (1218 m. ecu). Half the manufactures exports are made up of machinery and transportation equipment, electrical machinery and electronic goods. Malaysia is known for its exports of consumer electronics but is also a major exporter of air conditioners, office machinery and data processing equipment. Clothing makes up about 16% of its exports of manufactures to the Community and footwear another 8%.

The economy is set fair for a period of rapid growth. Apart from the threat of world recession, the major problems facing the policy-makers are rising inflation — officially 4% in 1989, up from under 1% in the 1985-87 period — and the balance of payments constraint, with the current account deficit now approaching 3% of GDP. There is also the divisive issue of how the government should intervene to tackle the inequalities of management, ownership and wealth between the different ethnic groups. The first New Economic Policy of 1970-90, designed to raise the relative economic position of the Malays, was relaxed during the recession years but government intervention in this area remains a live issue, while the successor to the NEP is being formulated.

Private investment has been the main driving force for growth, with direct foreign investment making a major contribution. Diversion of investment to the Community because of 1992 or to Eastern Europe does not appear, at least on the surface, to be a practical issue. Direct foreign investment has increased from the pre-1986 levels of less than M$1.7 bn per year to M$4.9 bn in 1988 and M$8.6 bn in 1989. Major projects include an aluminium smelter being built by a French firm, a tioxide pigment plant by a British company and a steel complex by a Taiwan company.

The Industrial Master Plan, announced in 1986, envisages a growth rate of 8.8% and over 700 thousand new jobs in manufacturing by 1995 (Ariff and Semudran, 1990, p.41). The plan includes the expansion of commodity processing, in particular of rubber, palm and palm kernel oil and cocoa, import substitution for non-ferrous metal products and emphasis on increased production in the non-metallic minerals sector, especially cement, glass and ceramics. 'The message is loud and clear; Malaysia must resort to large-scale manufactured exports in order to maintain high industrial growth' (*ibid.*, p.42).

The principal significance of the 1992 programme lies firstly in the threat of increased competition for Malaysia's exports of manufactures and diversion of trade towards EC producers, and secondly in the menace of EC protectionism in consumer electronics and footwear. Malaysia and the other ASEAN countries will be closely watching the evolution of the Community's MFA to see if that will bring improved access to the EC market.

Tropical beverages: The value of coffee exports would increase by some 225,000 ecus based on 1988 data. This probably underestimates the effects of harmonising taxes in the Community, since Malaysia's coffee exports have been expanding since then. The effects on cocoa export earnings would amount to 7.1 m. ecu — including the direct effects and the indirect effects through the rise in the world price.

Clothing and textiles: The estimated gains from abolishing member state subquotas are small — only 1.9%, taking the average of the alternative set of assumptions. This implies an increase in exports of MFA goods of 3.8 m. ecu. Again, the future of the MFA is much more important to Malaysia than the 1992 effect.

General trade effects: Malaysia is estimated to gain from trade diversion in primary goods by 44 m. ecu. Most of this derives from increased exports of crude rubber and tropical woods. In manufactures trade creation is estimated at 122 m. ecu of which more than half, 62 m. ecu, derives from machinery and transport equipment. This reflects Malaysia's importance as an exporter of electronic equipment and components. However, trade diversion is estimated at 163 m. ecu, considerably more than trade creation, with the major contributor again the machinery and transport equipment sector. In electronic components manufacture, which is becoming less labour-intensive, Malaysia's cost advantage over the EC member states with low labour costs will count for less. Another sector where trade diversion is likely is in wood processing. What was said in the context of Côte d'Ivoire is also relevant here.

Thailand

In 1987 Thailand exported goods worth 2.2 bn ecu to the Community. Of these 41% were primary goods, of which the most important were fish (104 m. ecu) and manioc (787 m.). Among manufactured exports, meat and fish products, particularly canned fish (159 m. ecu), clothing (361 m. ecu) and textiles (166 m.) were dominant. Exports of rubber and wood products, as well as those of footwear, have been growing rapidly.

Textiles and clothing: The exercise on the effects of eliminating member state subquotas on MFA products gives an average increase in Thai exports to the Community of 5.8% in volume terms. On the basis of 1987 trade data this gives an increase of 29 m. ecu. As in Sri Lanka's case, the effects of the possible phasing out of the MFA could dwarf this amount. Though Thailand no longer enjoys the labour cost advantage of the past, available data do suggest that it still has a major advantage over the NICs and Latin America (Hamza, 1989).

Fish: The new fish health and hygiene standards are likely to involve some adjustment costs because of pollution of coastal waters and fish farms from industrial wastes and insecticides. Thailand is not only faced with the new fish health and hygiene rules but also with new rules on live molluscs, which may be particularly difficult and expensive to satisfy.

General trade effects: Trade creation of primary products is estimated at a modest 10 m. ecu or 0.8% of exports to the Community. The main reason why the percentage rate is so low is the high weight of manioc in Thailand's primary product exports to the Community. Here trade creation is not possible as long as manioc exports are strictly controlled by voluntary export restraints. At 106 m. ecu trade creation is much more substantial in exports of manufactures. This includes an estimate of 20 m. ecu of trade creation in refined oil and oil products and 35 m. in clothing and textiles. Trade diversion at 106 m. ecu exactly offsets trade creation. It is concentrated in chemicals (27 m. ecu), machinery and transport equipment (16 m.) and textiles and clothing (40 m.).

Notes

1. In an effort to raise the world cocoa price, Côte d'Ivoire has taken the unorthodox step of unilaterally withholding supplies from the world market. However, there is no reason to suppose that the long-term price outlook has been affected by this policy.
2. Here we assume that 95.7% of Sri Lankan exports to the EC were covered by the MFA, the same figure as for developing countries as a whole.

8
The SEM and the Making of Policy

This chapter addresses, first, the threat of a more protectionist Community and, secondly, the impact on the world trading system of the various legal, administrative and other intermediate steps required to establish the SEM, and of the reorientation of the Community and its member states to a more collective and formal relationship with other countries and with multilateral organisations.

Community trade policy

Community Ministers and Brussels Commissioners have dismissed a 'Fortress Europe' as 'unthinkable', and yet their avowals of openness and respect for liberal trading principles have not stilled the anxieties of the outside world. The coincidence of the Uruguay Round with the run-up to 1992 has helped inhibit overt moves towards increased protection on the part of the Community but there have been many and increasingly frequent instances of 'administrative protection'. EC industry will continue to put pressure on the Commission, with support from sympathetic member governments, to pre-empt the 'unfair' advantages that 1992 may give to outside producers by restricting their market access. The pressure will not end on 1 January 1993. When an EC industry is in trouble, the temptation will be to put the blame on imports from third countries and to demand further protection.

On the microeconomic level, there is always the temptation to shift the burden of adjusting to the SEM on to imports. Integration will accelerate the process of structural change through the loss of Article 115 of the Rome Treaty, through increased labour mobility and through broad industrial rationalisation and relocation. The 1992 programme has been and will be used as a rationale for restricting competition from outside. Commission officials initially tried to argue that third countries would benefit from the creation of the internal market and be expected to undertake 'reciprocal' action to open their markets to EC exports.

Although not directly related to 1992, the Community's submission of July 1989 to the GATT Negotiating Group on Textiles and Clothing may indicate the sort of reciprocity that will be required.

> Contributions from all those involved, including from the textile-exporting countries according to their level of development, must ensure better access to markets through action on
> — tariffs and non-tariff measures;
> — derogations for balance of payments and infant industry reasons. (GATT, 1989a)

Several points need to be made. First, there is no suggestion that these contributions should be judged by a GATT committee or any other independent arbitrator. Clearly the Community expects to be the judge of whether such contributions are adequate. Secondly, the conditions are sufficiently vague — 'according to their level of development' — for them to be interpreted to suit the particular case in point. Thirdly, the Community talks about better access to markets, not specifically markets in clothing and textiles, and action on derogations for balance-of-payments or infant-industry reasons. One does not have to approve the GATT's acceptance of 'special and differential' treatment of developing countries to be concerned about the arrogation by one GATT member of the power to decide whether such treatment is appropriate in a particular case, using access to its own markets as the sanction. Complaints by the Community about the unilateralism of the United States trade bill are beginning to ring rather hollow.

Like voluntary export restraints, anti-dumping actions — one often leads to the other — have the advantage that they can be applied without going through the national legislatures or attracting much public attention. The recent spate of anti-dumping investigations suggests that 1992 may have already intensified resort to this instrument. A number of writers have discussed the increasing use by the Commission of anti-dumping actions as a protective device (including Davenport, 1989, Finger, 1987, Hindley, 1988, Messerlin, 1987 and 1988). This has been made easier by the lack of precision in Article VI of the GATT and the GATT Dumping Code. The Commission argues that its own regulations are consistent with the GATT. This may be so in a legalistic sense. In any event, the EC regulations are drawn up in such a way as to bias any dumping investigation, and any subsequent review, in favour of a positive result.

The number of anti-dumping actions against developing countries has risen significantly in recent years (Messerlin, 1988). Anti-dumping duties have been imposed on steel from Brazil and Mexico, on South Korean video cassette recorders and on paint brushes from China. In the early 1980s actions against firms in the developing countries concentrated on chemicals, steel products and building materials and largely affected the countries of South America. Since then the trend has been turned against exporters of high technology products which have taken a rising share of imports and, with that, anti-dumping proceedings over the last few years. Initially they were mainly directed at Japanese companies. Now actions are being increasingly aimed at the Asian NICs.

Under the EC regulations on anti-dumping, these actions present a particularly effective way of tackling post-1992 adjustment problems and imposing the costs of adjustment on to the outside world. Anti-dumping actions can be effected quickly. Indeed, provisional duties can be imposed immediately. Decisions about which complaints should be pursued are primarily in the hands of the Commission. The investigating rules are set up generally to produce the desired outcome. Then either a definitive duty is imposed or negotiations are opened with the exporting firm to elicit the appropriate response in the form of a price undertaking or a VRA or both. On top of all these advantages, Commission officials and national politicians can claim that they are only trying to protect jobs from unfair trading practices.

1992 and the world trading system

It is important to define the differences for the trading system between the SEM and a common market or free trade area, and why the process of its formation is likely in itself to have an impact on the international system. The SEM will affect the way in which future GATT negotiations are carried on and the trading system that emerges from them, and could influence patterns of trade more generally. Many of these effects will be particularly strong for developing countries.

In goods, the trade diversion and creation effects do not, with minor exceptions, stem from the lowering of traditional tariff barriers to trade. This immediately differentiates the SEM from the

North American free trade area and EFTA, and from most developing country groupings. In the European Community, the tariff elimination effects have already happened (except for some remaining transitional arrangements for Spain, Portugal, and Greece).

The SEM effects go beyond these. First, they include some conventional non-tariff barriers. It is now well accepted that their 'tariff equivalents' do not in any useful sense measure their effect, since they are not equivalent to tariffs. Removing them will change incentives and perceptions, and remove distortions, in addition to the tariff effect of reducing costs. Removal of those with external effects could be particularly beneficial to developing countries (in aggregate) because they have faced most non-tariff barriers.

The second difference goes beyond trade, to encompass agreements on mutual recognition of standards, and national-economy-type regulation of disparities among taxes and of cartels or mergers. The spread in the number of goods and services for which there are standards, the increased strictness that is occurring in some, and simply the greater frequency with which they are being adopted create serious informational problems even for the most advanced suppliers to the Community. Developing countries, particularly small or poor ones for whom the fixed informational costs are higher relative to the actual or potential trade flow, will suffer most. New entrants will also suffer because the act of setting standards increases the barriers to entry. Developing countries will also suffer disproportionately because many of the products to be regulated are among their exports: toys, plants, fruit and vegetables, fish and shellfish, and meat.

The third change is one whose effects were probably underestimated by the EC's own studies: the removal of all border controls. This is not simply a mechanical consequence of the others: it depends on them: although until all goods are free of barriers, every shipment must be checked if only to ensure that it does not come under one of the remaining controls. This is what industry or commercial commentators invariably list first as the 1992 effect. The freedom from delays and bureaucratic 'hassle' for any shipment is not important 'only' for small firms (as the Community's estimates of 1992 effects suggested). Studies of firms' behaviour suggest that improvements in administrative procedures have a significant effect, and this probably removes an important barrier to entry (in the traditional, not the trade sense).

This reform is an essential tool for the SEM's purpose of increasing internal trade, and therefore potentially has large trade diversion effects, which our partial equilibrium analysis may not have fully captured. It will help outside suppliers as well, but principally those large enough to be supplying several EC countries, and therefore regularly involved in trans-shipments. The benefits to developing countries may, therefore, be less than to non-EC industrial countries, and the diversion damage may be greater: it is likely to be lower-value goods which have been more constrained by high costs of transit.

Fourth, as we have seen, goods such as tropical beverages and tobacco which have up to now largely escaped GATT trade negotiations (and which are frequently excluded from other free trade areas) are included. Similarly, trade in services has become a 'new area' in the negotiations, and one not covered in most other regional trade agreements. Because of the nature of services, they are more likely to be government-regulated than (most) goods. More services require 'prudential' or health regulation. An efficient market, without regulation, is more difficult because the provision and consumption of services are time-specific, introducing potentially large discontinuities in supply and demand; they are often supplied over a period of time, making fully informed decisions at the outset difficult, and requiring additional information about the company providing them and about changes in the market, or creating additional risks. The reconciliation of markets and regulations is difficult even at the national level; it requires the nature of negotiations at the international level to change, within the Community but also with the rest of the world. There might also be a further important effect because so many services are trade-related. If the efficiency effects are significant, the cost of trade, within and outside the Community, will fall, possibly precipitating a step increase in its relationship to income or production.

The sixth difference again brings us to the international institutional system. Free trade areas (including the North American) do not imply a common external policy, and even other common markets or pacts do not carry this as far as the EC does. The Community is the competent negotiator in the GATT. Bringing more areas into EC competence for internal purposes through the SEM means that the role of unified EC policy, not simply the roles of its member states, must increase in these areas, although, as will be discussed below, there are still unresolved issues here. Common policies on such issues as rules of origin and the administration of trade negotiations with individual other countries mean that trading partners must be aware of the complications of member state-Commission relations. Where a unified policy does exist, it brings consequential effects: the Community is increasingly, and self-consciously, a new strong economic bloc.

The SEM goes beyond product markets to factors of production. It requires removal of formal internal restrictions on mobility of labour and capital, and efforts are now directed at relaxing domestic regulations or standards that obstruct this movement. The Community is also moving towards monetary co-ordination and/or union. This should have the effect of reinforcing all the other improvements in market functioning (it is ultimately justified and based on such effects). As in trade-related services, these changes could reduce the cost of all trade, if the removal of capital controls and monetary union do promote more efficient financial and other markets.

All these changes are moving the Community into a status which falls between a common market and a country, and which is difficult to accommodate, in theory or in practice, in an international system which is formally equipped only to encompass one or the other, and which in practice has had difficulty even with common markets. The common external policy and monetary union should also affect the Community's role in the international monetary and payments system; the concurrent roles of the Community and its member states in the international institutions and in relationships like the Franc Zone constitute one of the ambiguities of the current situation.

The use of the terminology and methodology of labour and capital movement 'creation' and 'diversion' implicitly requires the assumption that the efficiency and welfare effects of these are well understood, which is uncertain, and that they correspond to national policy. Only where foreign investment is wanted can its 'diversion' be a loss to non-EC members. 'Creation' of demand for non-EC labour may not fit Community political priorities.

The complications of the transition: Some of these complications are inevitable (seen from an EC point of view) as various international policy arrangements are moved from national to Community level, but all (seen from outside the Community) involve technical, and potentially damaging, inconsistencies. What for other countries would be national concessions and controls on trade which are outside the GATT, against the GATT, or involve derogations from the GATT, are at present divided between the member states and the Community, and moving from one to the other. The Generalised System of Preferences is now almost entirely at Community level, but income per capita in individual member countries is still treated as a legitimate criterion for granting eligibility to supplying countries, and this permits the exclusion of some higher-income developing countries. MFA restrictions and special entry guarantees for traditional suppliers of bananas or rum are bilateral, and how to move these to Community level or find alternative ways of enforcing country differentiation remains an unresolved issue (see Chapter 3). Most of the quotas, VERs, industrial arrangements and other contrary-to-GATT controls are at member state level. Some, however, are acknowledged at Community level, and enforced under the Article 115 provisions which allow restriction on intra-EC trade to enforce extra-EC controls. It is, however, the Community which is responsible to the GATT for the Uruguay Round commitment to roll-back and standstill on such measures, and whose trade policy will be examined under the new powers given to the Secretariat. The quotas which are allowed by the GATT because they predate GATT rules (Italy on Japanese cars, for example) are for GATT purposes country-specific, and also depend on Article 115.

On the new areas where there is little or no tradition of international negotiation, the Community can take the initiative from the beginning. On those where there are existing bodies (non-GATT organisations regulating shipping, air services, intellectual property, for example), the situation remains uncertain. The clearest complications arise in capital flows, money, and exchange rates. The Community member states are individual (and, as seen over reallocation of IMF quotas in 1990, not always harmonious) members of international bodies, and individual donors of aid or regulators of banking systems, but the existence of intra-EC capital mobility, non-discrimination on government procurement, and co-ordinated, if not common, exchange-rate policy makes it difficult to treat them as totally independent.

The coincidence of the SEM transition with the GATT Uruguay Round, the growing participation of developing countries in international trade and trade negotiations, and the formation of new free trade areas or other regional links poses special dangers. Preoccupation with 1992 almost prevented the Community from supporting the holding of the Uruguay Round negotiations, and it still means that both officials and economic groups in the member states are much less concerned with its outcome than is the case, for example, in the United States. From the beginning, the Community has given the impression of not having any very strong objectives for the outcome (such as the US had for services or agriculture, and many developing countries have for agriculture, tropical products, or textiles and clothing). It has defensive ones (concessions on intellectual property or access to developing country markets in exchange for any changes on the MFA), but the GATT is clearly not the most important international trade forum for Community policy in the early 1990s. The effects of this timing may, however, have been more favourable in the opposite direction. One of the motives for the Round was to help the US Government constrain US protectionism; it may be having a similar effect on the EC instinct to pass on to outside suppliers any costs to producers of greater economic union.

The areas where progress is being made in the GATT round may also affect the nature of the SEM: if trade in textiles and clothing is put on a transition path to a non-MFA system, then it is not administratively worthwhile to find a substitute for Article 115 to separate national markets for these sectors for 7-8 years. If the only remaining beneficiaries of preserving national markets are a few minor banana exporters, then *ad hoc* measures, whose breakdown would not be regarded as serious, may suffice.

The 'diversion of negotiators' interest' (not just to 1992, but now to Eastern Europe as well) is important, however, and not just because it may limit the outcome of the Uruguay Round. Treating multilateral negotiations as secondary does not encourage developing countries, many of which are new, or newly active, GATT members, to consider them a strong part of the international trading system, or, by extension, to treat the opening of multilateral trade as a useful policy to pursue. The Community has been relatively backward in debt and other capital flow initiatives for developing countries in recent years.

Effects on the GATT: Experience in negotiating 1992 has led to important positive effects for the scope of the Uruguay Round. The Community has had much more experience than other parties in introducing new subjects into trade negotiations; in encouraging countries to accept that previously 'purely national' parts of the economy — services, investment incentives, subsidies with international effects, government procurement, etc. — are now legitimate areas for international concern. It knows how to find ways to broaden the competence of international negotiations. The Commission's experience in increasing its own areas of competence as new issues are introduced may have been an example to the GATT: its new examinations, if not yet supervision, of member states' trade policies; its more active and public role in seeking agreement, bilaterally, with its trading partners. The GATT negotiations in turn reinforce the Commission's own position: bringing new areas under the GATT, where the Commission is recognised as competent, implies, if it does not require, a stronger EC role relative to member state governments. The Community also has the practical knowledge of where difficulties can arise from combining different national systems, as well as different national interests. The new subjects which were introduced into the Uruguay Round are in many cases also 1992 subjects, and therefore they are less new to Community negotiators. This could help explain why progress in some of these areas, notably services, has been faster than had been expected.

It has also meant an increased ability and willingness to identify the protective effect of other countries' arrangements. On agriculture, other countries have led, but in steel and engineering goods, and probably also on phyto-sanitary regulation, the Community can use its experience with its own members to examine other countries' actions. This may facilitate the type of close examination of countries' trading systems embodied in the new GATT supervisory provisions.

But, on the other side, the Community's experience in looking beyond trade to domestic trade-affecting measures can be used to extend the boundaries of protection as well as those of trade negotiations. Setting rules of origin or national composition to restrict the benefits of trade concessions to developing countries (a problem for ACP and GSP beneficiaries) or to extend the coverage of quotas (the proposal to include products of Japanese car companies' operations abroad in quotas for Japanese cars) could become more important risks for the trading system. All this experience of trying to define the trade effects of national policies and then apply Community rules to them directly, not through GATT agreement, may make it hard for the Community to challenge credibly the legitimacy of the US Super-301 'crowbar', or the strategic impediments initiative against Japan.

Another negative effect is that the Community is looking for, and finding, more precisely targeted forms of trade intervention to use after 1992 to replace those that will become less flexible after the Round. This incentive to develop new weapons of protection (which other countries, developed and developing, have not been slow to adopt) helped to refine and increase the use of anti-dumping actions. These are in turn made more effective by experience gained within the Community of close examination of countries' subsidies and taxes on individual sectors, or regions, which can offer 'unfair' advantages in trade. Efforts to define a Social Charter within the Community have been accompanied by growing Community acceptance (and indeed pressure from industrial and union interests) for a social clause in trade with developing countries, although not with other industrial countries. The continuous shifting, and blurring, of the border between 'international' and 'domestic' policies is inevitable within the evolving Community, but is also related to the growing importance of trade within all countries.

In one respect, the Community approach to trade is the antithesis of multilateral, and this could be a danger to a faltering or unsuccessful GATT Round. All major countries face the choice between bilateral and multilateral relations. But the Community, much more than the United States or Japan, has always divided the rest of the world into clearly ranked groups in its trade policy: its own member states, EFTA, the Mediterranean countries, the Maghreb, the ACP, the GSP countries (with further subdivisions), etc. Its first reaction to Eastern Europe has been to assign it a step on this pyramid (between EFTA and the Mediterranean) and to package it, with new trade concessions and capital arrangements, in the European Bank for Reconstruction and Development (EBRD). The SEM has probably not actually increased this tendency, although it has reinforced it through requiring more formal definitions of trading relations with traditional partners. In a few cases (notably EFTA and the ACP), it may have provided further encouragement to its trading partners to adapt their own trade policies more to this, and to seek new, more special, arrangements. Fears that the world is dividing into regional blocs have been increased by the move to the SEM. But they do not seem justified from the relatively minor direct effects on third countries which can be identified by either macro or sector-by-sector approaches, or indeed by actual changes in patterns of world trade.

More Community quotas, more EC standards or mutual recognition of standards, and more EC use of anti-dumping could have an important practical effect on the world trading regime, and also on the economic climate in the next few years. In their immediate effects, they increase protection. EC and non-EC countries that did not participate before will be covered by quotas. As described in Chapter 4, the setting of standards, and the standards themselves, can have a protective effect: particularly with respect to goods which are not produced within the Community (including many horticultural and fish products of interest to developing countries), the absence of EC producers and the presence of those who produce substitutes may lead to health and safety standards being set in forms which pay minimal regard to cost or feasibility. The use of anti-dumping has been seriously and deliberately protectionist, and it is seen as the substitute for the MFA. But it could also be a weapon for the developing countries to adopt, to mitigate any reduction in their barriers required in the Uruguay Round. It seems increasingly likely, for example, that opening their markets to imports of textiles and clothing products will be part of any agreement to phase out the MFA.

For the trading system in the medium term, however, it is significant that quotas and standards, when applied by an international organisation and administered by national authorities, and anti-dumping, under all circumstances, require detailed, legally verifiable, criteria and procedures. They are therefore subject to examination and challenge. They are replacing national measures which were in many cases completely matters of administrative discretion, or even managed by an industry cartel, as with cars.

One of the most damaging changes to the trading system after 1974 was the growth of uncontrolled, semi-official, 'grey area' trade interventions, outside not only the GATT but countries' own normal procedures for government accountability. This created a climate of uncertainty about future (sometimes even actual) protection which reinforced the damaging effect of the actual protectionist actions. This breakdown in international observance of rules extended also to interest-rate and exchange-rate management, where again experience in the Community is bringing a move back to a more regulated if not fixed system. If the need to define national measures to make them enforceable at Community level reinforces the bringing of the 'new areas' of agriculture, services, etc., into the GATT and the restoration of the derogated areas like the MFA, the international system that emerges could move trade back towards the rule-based path followed from the formation of the GATT to the early 1970s. The most extreme signs that the international climate is changing are the calls for the GATT finally to become the International Trading Organisation that was originally intended, with a more formal continuing role of monitoring, regulating, and enforcing trading rules. These are led by an EC member state (Italy). Small, economically weak, countries, especially those not members of any regional group — categories which would include many of the developing countries — would gain from these changes.

On the whole, breakdowns in international economic order have been damaging in the past (in the 1930s as well as the 1970s) and restorations, as with the founding of the GATT itself, have been favourable. They do carry the same short-run problem that stems from the Community's growing use of common standards: that more regulation requires a more experienced or more professional approach to trade, perhaps favouring large countries or companies. It has been argued that this would increase the gap between successful countries and the poorest. This is probably not correct, as the risks from the present erratic system are probably at least as great, even if they are not so visible. An unregulated system with unpredictable government intervention and management is unlikely to offer efficient markets.

If, however, the SEM does produce something more like a country than a collection of countries, it could increase the risk that the international trading system is dominated by co-operation among a group (in industrial language: controlled by market-fixing within a cartel) of three participants, as has already happened on exchange rates. However benign such co-operation may seem to the participants, economic theory does not suggest that it will necessarily benefit the rest of the world. It does not have the advantages of either market or regulated economic relationships. It is always difficult to distinguish (non-subjectively) between intervention to improve markets and interference in them. One effect of 1992 is to make the Community more conscious of an ability to wield US-type economic power, illustrated by its issuing of lists of US malpractices in trade in reply to those published by the United States.

The outcome of these two conflicting influences, the move to rules and the abuse of size, on the nature of the trading system is not yet clear. The still different commercial interests of the EC member states, the fact that they do not act as a unit in other international organisations, and perhaps even the Community's distraction by 1992 during the Uruguay Round may encourage the return to rules.

To sum up, if the optimistic view is taken of the transparency and return to legal order effects of 1992, these offer benefits to all the Community's trading partners. Developing countries would benefit more because they have more difficulty in an uncertain, poorly informed system. But if 1992 accelerates the move of international regulation into new areas and new controls on old ones, this could bring these countries under constraints on the types of policies they can pursue and the instruments they can use at a much earlier stage in their development than when such constraints were imposed on the present developed countries. While the least developed may be protected from this, those above this classification will be even less protected than at present and will face even more extensive international regulation. There is no clear indication from theory whether this will benefit them. The benefits from more open trade must be measured against the dynamic costs of constraints on industrial strategy. On new areas, such as the regulation of services or the appropriate weight to be given to intellectual property rights, it is by no means clear whether countries which are still large-scale importers of these will gain from regulations which have evolved to suit the exporters, and which the present developed countries refused to accept when they were net importers. If 1992 leads to less multilateral decision-making and a clear shift to a three-sided oligopoly, the probability is that developing countries (together with the smaller industrial countries) will lose out (at least in aggregate).

Appendix 1
Calculation of General Trade Effects

Trade creation: The Cecchini Report estimates that the SEM will result in a once-and-for-all increment to Community GDP of between 4.25 and 6.5% of GDP. This is a wide range and it would be useful to narrow it down for the purposes of this study. The background studies for Cecchini calculate the dynamic effects in two alternative ways (Commission, 1988a). The first method is to take separate estimates of the effects of restructuring and increased production using Pratten's estimates of potential economies of scale (1988), and of the effects of increased competition on costs through reduced X-inefficiency by extrapolating the case studies of Smith and Venables (1988). The second method is to take a single estimate of the market integration effects again by analogy with the sectoral Smith and Venables results.

The independent (Variant I) estimates of the economies of scale effects are probably exaggerated, since the methodology assumes that the completion of the market results in all surviving firms in any sector moving from their actual size to the minimum efficient scale (MES) for that sector. The Smith and Venables (1988) methodology assumes that firms are already at the appropriate MES for the limited market size. It does imply that any SEM gains through economies of scale will be much more limited. This difference could explain the gap between the growth impacts estimated by Variants I and II.

If the economies of scale effect in Variant I is reduced by a half, the range for the impact of the 1992 programme on Community GDP is narrowed to 4.3 to 5.4% and the two approaches to quantifying the dynamic effects become more consistent. For the purposes of this study we took 5% as the central GDP growth effect (of which perhaps as much as a half has already been realised).

For trade creation in primary goods a 32-sector breakdown was used and goods subject to CAP variable levies were then excluded.

The products included were fishery products, tropical fruit and nuts, tropical beverages, spices, oilseeds, fats, oils, oilcake and meals. For each sector the income elasticity of import demand was taken from the literature or, where an elasticity was not available, the elasticity appropriate to the closest higher level of aggregation was applied. The sources of elasticities were as follows: foodstuffs — Caspari et al. (1980) where available, otherwise 0.6 on the basis of Balassa (1988) and Reidel (1984); minerals and metals — Bond (1983); other agricultural raw materials — the median estimate from Goldstein and Khan (1984), Balassa, Reidel, Rollet (1983) and the IMF Multimod model (Adams and Adams 1989); mineral oils — the median estimate from Goldstein and Khan, Balassa and Rollet. The elasticity for food and tobacco given in Table 2.1 is an average, weighted by developing countries' exports, of the elasticities of the six separate categories which were used in the calculations.

Trade diversion: To estimate trade diversion with a partial equilibrium model, data on SEM-related cost reductions are required. For the barrier removal (direct) effects, we took figures from the relevant Cecchini study, matching the EC's NACE-CLIO sectoral disaggregation to the 8-sector breakdown of manufacturing used in this study. For the competition effects no sectoral estimates of cost reductions are available. However, Smith and Venables (1988) estimated the cost effects of market integration for ten illustrative sectors using a model of imperfect competition and returns to scale. For all the sectors they assumed an initial 2.5% reduction in costs, relative to intra-EC trade, whereas the Cawley-Davenport study started off from different initial cost reductions for each sector. We adjusted the Smith-Venables results (from the Cournot variant of their model with variable numbers of firms) proportionately to the Cawley-Davenport initial assumptions, matching as closely as possible to the breakdown used in this study. For two sectors not included in the Smith-Venables study, textiles (SITC 65) and clothing (SITC 84), dynamic cost reductions were assumed to be unavailable.

Table A1 sets out the estimates of trade diversion by sector. The static trade effects are taken from Cawley and Davenport (1988) and the market integration effects calculated as explained above.

Terms of trade effects: For price rises in primary product world markets, the same income elasticities of import demand as in the trade creation exercise were used. In the food category, prices of products with CAP variable levies were assumed not to react to

Table A1
Trade diversion in manufacturing, trade barrier (static) and market integration components (%)

SITC		*Static trade diversion*	*Market integration effects reduction in*			*Total trade div'n.*
			costs	*prices*	*imports*	
18						
5	Chemicals	10.0	2.5	2.0	12.0	20.7
6	Manufactured goods classified by material,	8.2	1.2	1.0	5.8	13.5
except						
65	Textile yarn	5.6	0.0	0.0	0.0	5.6
7	Machinery and transport eqpt.	6.9	1.5	1.2	7.1	13.4
8	Miscellaneous manufactures,	5.2	0.5	0.4	2.6	7.7
except						
84	Clothing	5.6	0.0	0.0	0.0	5.6
85	Footwear	5.8	0.1	0.1	0.4	6.2

increased Community demand. In each case the increase in world demand is given by the product of the EC share in world imports, the assumed rise in Community GDP of 5% and the import elasticity of demand. The increase in world prices is calculated as the percentage increase in world demand divided by the sum of the absolute values of the price elasticities of import demand and export supply for each class of primary product (taken from Matthews, 1989 who derived them from Bond, 1983). Data were taken from UNCTAD *Commodity Yearbook 1989*. For each category, the value of imports from the developing countries or ACP states was derived by multiplying their exports by the ratio of world imports to world exports.

For the reduction in the price of EC exports of manufactures, an average, using developing country import weights, of price reductions (by 2-digit manufacturing group) due to the 'direct effects' of 1992 was taken from Cawley and Davenport (1988). This yielded an average reduction of 2.03%. The same figure was used for ACP imports and for individual developing countries.

Appendix 2
Details of Results of Simulations of Alternative Banana Regimes

Table A2 shows impacts on groups of EC, ACP and dollar producers of the impacts of the alternative regimes discussed in the text. The dollar producers will benefit under any of the scenarios. Their export volumes, revenues and market shares will improve in all cases. The largest gains come under a free market, while, because of the favourable volume effect, they do better under a deficiency payments system than under a quota system. Here we simply draw attention to some of the most critical features of the alternative schemes.

Under a free market with a 14% CET the EC/ACP suppliers lose nearly three-quarters of their export revenues, while their market share falls from 52 to 28%. The export earnings of the dollar producers climb from 740 m. ecu to 1016 m. ecu. The average price in the Community falls from 56 ecu/100 kg to 46 ecu, roughly the present average price in the free markets. Clearly there will be substantial consumer surplus gains in the United Kingdom, France, Italy, Spain, Portugal and Greece. The Community budget gains from increased tariff revenues to the tune of 40 m. ecu, which would help to cover some of the cost of technical assistance to the ACP and EC producers.

Under the deficiency payments system with a dual price guarantee — 70 ecu/100 kg for EC producers and 50 ecu/100 kg for ACP producers and a 14% CET — the volume of EC/ACP exports would fall by about 16% while export revenues would fall by 24% relative to the current situation. The share of the Community market supplied by the dollar producers would rise by some 10%. Despite the reduction in the CET tariff revenues would rise because of the elimination of the German tariff quota and because of the increase in imports from the dollar producers. The increase in tariff revenue would in this case come to 17 m. ecu, but the budgetary cost of the deficiency payments, under these assumptions, would amount to some 183 m. ecu, leaving a net budgetary cost of 167 m. ecu, not greatly different from the net budgetary cost of a free market plus a compensation scheme for EC/ACP producers costing some 200 m. ecu (discussed in the main text). In the deficiency payments scheme consumer gains would be similar to those under a free market.

Under a quota system with a 14% tariff the EC/ACP producers do marginally better than under the deficiency payments scheme. It is assumed that economic rents generated by the quotas accrue to the producers. As discussed in the main text, if the quotas are administered by giving licences to trading companies, these companies would be in a position to appropriate a share of the rents. How much would be passed down to the producers themselves would depend on the relative market power of the different parties. If the quotas were auctioned to the dollar producers, the EC price would end up much lower, though still above the existing price received in the free markets (because of increased demand from the currently restricted markets). An overall quota on dollar imports rather than individual quotas for dollar producers would yield a similar outcome, as the EC market price would be forced down through competition and EC consumers would gain at the expense of the dollar producers or mncs. Under the quota scheme simulated here the major losers, relative to the current trade regime and the other alternatives, are the consumers in Germany, Benelux, Ireland and Denmark.

Finally, a mixed deficiency payments-quota system with a 14% CET and differentiated price guarantees for ACP and EC producers would result in higher prices on the EC market, a higher market share in value terms and a considerably lower net budgetary cost than the deficiency payments scheme without quotas. In this case the EC consumers rather than the budget bear the cost of high prices for the ACP producers (who in this example do not take up the guaranteed prices) and most of the cost of the high prices paid to EC producers.

Some alternative simulations with different CET or price guarantee levels are also included in the table.

Elasticity assumptions and sensitivity analysis

On the basis of Islam and Subramanian (1989), the long-term income elasticity of demand for bananas in the Community was assumed to be 0.58. The import demand elasticity with respect to price was

Table A2
Simulations of alternative import regimes for bananas: effects on main producer groups (m. ecu and %)[a]

Producers	*EC*	*Carib.*	*Other ACP*	*EC/ACP*	*Dollar*	*Total*
1988 data:						
Price cif EC						
ecu/100 kg	69.6	75.6	54.5	68.3	46.0	55.5
Exports to EC,						
'000 tonnes	702.0	285.0	218.0	1205.0	1609.3	2814.3
m. ecu	488.4	215.4	118.9	822.7	740.3	1563.0
- as % total	31.2	13.8	7.6	52.6	47.4	100.0
Ia: Free Market, 14 % CET Price cif EC						
ecu/100 kg	46.0	46.0	46.0	46.0	46.0	46.0
Exports to EC,						
'000 tonnes	403.0	134.0	203.5	740.5	2208.1	2948.6
m. ecu	211.3	70.3	106.7	388.3	1015.7	1404.0
- as % total	15.1	5.0	7.6	27.7	72.3	100.0
CET revenue[b], m. ecu					-5.7	39.8
Ib: Free Market, 20 % CET Price cif EC						
ecu/100 kg	46.0	46.0	46.0	46.0	46.0	46.0
Exports to EC,						
'000 tonnes	451.2	152.0	222.6	825.8	2098.2	2923.9
m. ecu	249.0	83.9	122.9	455.8	965.1	1420.9
- as % total	17.5	5.9	8.6	32.1	67.9	100.0
CET revenue, m. ecu					45.0	108.1
IIa: Deficiency Payments; EC 700 ecu/tonne, ACP 700 ecu/tonne						
Price cif EC						
ecu/100 kg	70.0	70.0	70.0	70.0	46.0	46.0
Exports to EC,						
'000 tonnes	709.5	248.5	325.0	1283.0	1508.8	2791.8
m. ecu	496.7	174.0	227.5	898.1	694.0	1592.1
- as % total	31.2	10.9	14.3	56.4	43.6	100.0
CET revenue, m. ecu					-50.9	-5.3
Budget cost[c],						
m. ecu	170.3	59.7	78.0	307.9		307.9

Table A2 (continued)

Producers	*EC*	*Carib.*	*Other ACP*	*EC/ACP*	*Dollar*	*Total*
IIb: Deficiency Payments; EC 500 ecu/tonne, ACP 500 ecu/tonne						
Price cif EC						
ecu/100 kg	50.0	50.0	50.0	50.0	46.0	46.0
Exports to EC,						
'000 tonnes	360.4	118.1	186.6	665.1	2305.3	2970.4
m. ecu	180.2	59.0	93.3	332.6	1060.4	1392.9
- as % total	12.9	4.2	6.7	23.9	76.1	100.0
CET revenue, m. ecu					0.4	46.0
EC Budget cost,						
m. ecu	14.4	4.7	7.5	26.6		26.6
IIc: Deficiency Payments; EC 700 ecu/tonne, ACP 500 ecu/tonne						
Price cif EC						
ecu/100 kg	70.0	50.0	50.0	61.7	46.0	46.0
Exports to EC,						
'000 tonnes	709.5	118.1	186.6	1014.2	1855.2	2869.5
m. ecu	496.7	59.0	93.3	649.0	853.4	1502.4
- as % total	33.1	3.9	6.2	43.2	56.8	100.0
CET revenue, m. ecu					-28.6	17.1
Budget cost,						
m. ecu	170.3	4.7	7.5	182.5		182.5
IIIa: Quotas on dollar bananas, 14% CET						
Price cif EC						
ecu/100 kg	57.7	57.7	57.7	57.7	57.7	57.7
Exports to EC,						
'000 tonnes	635.0	220.7	295.4	1151.2	1609.3	2760.5
m. ecu	417.4	145.1	194.2	756.7	927.9	1684.6
- as % total	24.8	8.6	11.5	44.9	55.1	100.0
CET revenue, m. ecu					-18.1	21.7
IIIb: Quotas on dollar bananas: 10% CET						
Price cif EC						
ecu/100 kg	59.8	59.8	59.8	59.8	59.8	59.8
Exports to EC,						
'000 tonnes	617.8	214.3	288.6	1120.7	1609.3	2730.0
m. ecu	400.0	138.7	186.9	725.6	947.2	1672.8
- as % total	23.9	8.3	11.2	43.4	56.6	100.0
CET revenue, m. ecu					-53.3	-24.7

Table A2 (continued)

Producers	*EC*	*Carib.*	*Other ACP*	*EC/ACP*	*Dollar*	*Total*
IVa: Deficiency payments with quotas						
EC 700 ecu/tonne, ACP 500 ecu/tonne, CET 14%						
Price cif EC						
ecu/100 kg	70.0	63.6	63.6	67.3	55.8	55.8
Exports to EC,						
'000 tonnes	709.5	207.1	281.0	1197.6	1609.3	2807.0
m. ecu	496.7	131.8	178.9	807.3	898.5	1705.4
- as % total	29.1	7.7	10.5	47.3	52.7	100.0
CET revenue, m. ecu					-22.3	18.5
Budget cost,						
m. ecu	45.1				45.1	45.1
IVb: Deficiency payments with quotas						
EC 700 ecu/tonne, ACP 500 ecu/tonne, CET 10%						
Price cif EC						
ecu/100 kg	70.0	62.2	62.2	66.8	56.6	56.6
Exports to EC,						
'000 tonnes	709.5	197.9	271.3	1178.7	1609.3	2788.0
m. ecu	496.7	123.2	168.8	788.7	910.5	1699.2
- as % total	29.2	7.2	9.9	46.4	53.6	100.0
CET revenue, m. ecu					-20.6	19.8
Budget cost,						
m. ecu	55.1	0.0	0.0	55.1		55.1

Notes

a. Only EC, ACP and Latin American exporters are included in the totals.
b. The change in tariff revenues excluding the elimination of the German tariff quota is given in the dollar column. The effect of eliminating the tariff quota is included in the 'total' column.
c. The budgetary cost does not take into account the change in tariff revenues.

assumed to equal -0.5 for the Community. The FAO Intergovernmental Group on Bananas (1979) found estimates for Europe ranging from -0.21 for the United Kingdom to -0.58 for Germany with a weighted elasticity of -0.46 for the six countries. Islam and Subramanian found -0.39 and -0.40, depending on the specification. Valdes and Zietz (1980) used a figure of -0.45 for world demand, but do not explain where it comes from.

Only one estimate of the world export supply elasticity has been found in the literature. Valdes and Zietz used 1.73 but do not explain how it was calculated. This figure was used for the long-term supply elasticity of the EC/ACP countries. However, it appears rather low for the world export price elasticity. This was set at a value of 3, but it should be noted that it does not feature as a parameter in the estimation of the effects of alternative import regimes. It is only used in the estimation of the income effects from increased Community GDP.

The world supply schedule facing the restricted EC member state markets is assumed to be perfectly elastic, on the grounds that these markets constitute a small part of total world demand and thus the 'small country' assumption is valid. However, if the elasticity of supply of the dollar producers is assumed equal to that of the ACP/EC producers at 1.73, the following results for the free market scenario with CET at 14% are obtained:

Producers	EC	Carib.	Other ACP	EC/ACP	Dollar	Total
CET Price cif EC Ia: Free Market, 14%						
ecu/100 kg	51.8	51.8	51.8	51.8	51.8	51.8
Exports to EC,						
'000 tonnes	519.0	177.3	249.5	945.8	1962.2	2908.0
m. ecu	306.7	104.8	147.4	558.9	1123.9	1682.7
— as % total	18.2	6.2	8.8	33.2	66.8	100.0
CET revenue, m. ecu					9.3	52.0

Clearly the results are better for the EC and ACP producers than those of the preferred elasticity assumptions. Nevertheless their loss of export revenues is still severe. As a group they now lose 264 m. of their initial 823 m. ecu revenue rather than the 434 m. ecu lost under the infinite supply elasticity assumption. The 1.73 elasticity used here is the other extreme from the infinity assumption. The latter probably gives a more realistic picture of the actual effects. Incidentally, in the event of a quota the results are obviously unaffected by the elasticity of supply.

Appendix 3 Elasticity Assumptions; Tropical Beverages and Tobacco

The income elasticity of demand for coffee in the Community and world-wide was taken as 0.47 (Islam and Subramanian, 1989). Price elasticities of import demand for individual EC member states, where available, were taken from Vogelvang (1988). They were for Germany -0.20, for France -0.30, for Italy -0.32, for the UK -0.56, for the Netherlands -0.39, for Belgium/Luxembourg -0.31, for Denmark -0.40 and for Ireland -0.67. For other member states and for the rest of the world -0.27 (Islam and Subramanian) was used. The elasticity of export supply for ACP suppliers was taken as 0.46 and for other suppliers as 0.65 (Askari and Cummings, 1976, Bond, 1983 and Valdes and Zietz, 1980). On the basis of the same sources, for cocoa the price elasticity of demand was set at -0.58 and the supply elasticity at 0.8. For tobacco the elasticities were set at -0.4 and 0.4 respectively.

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