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Overseas Development Institute

Briefing Paper

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THE DEVELOPING COUNTRIES AND 1992

Developing countries are not considered in the European Commission's studies of the effects of its 1992 programme. But the goals of 1992 depend on a radical restructuring of Community internal and external trade. This Briefing Paper summarises the principal effects of 1992 on the ldcs. Overall, 1992 is likely to have a limited but positive impact on developing countries, unless the Community adopts a restrictive import policy in an attempt to shift the burden of economic adjustment to outside suppliers.

'..a dynamic European market, trading with the world on a footing of revamped competitiveness, will provide a much-needed shot in the arm for other markets and economies in less buoyant shape.' (Cecchini Report, p.xix).

The goal of the 1992 programme is a unified trading bloc, with the movement of goods, services, labour and capital between member states as unrestricted as movement within a member state. At present the market is fragmented by a web of barriers and regulations. Removing these is expected to reduce production and distribution costs, increase competition among EC producers and lead to the rationalisation of plant, economies of scale and other advances in efficiency. The Commission estimates the gains to the Community of 1992 at up to 7% of the EC gross national product and up to 5m jobs by the late 1990s.

The removal of internal barriers has far-reaching implications for EC trade. For individual members, the structure of imports from outside the EC reflects firstly a complex of preferential arrangements based on historical trading patterns. Secondly, EC participation in the world-wide spread of protection in agriculture, steel, textiles, footwear, and recently, consumer electronics, has limited the role of free international competition.

Preferences for traditional suppliers or protection against third countries when established by individual member states, like barriers to intra-EC trade, are inconsistent with the 1992 programme. Bilateral protection or import guarantees may or may not be replaced by protection or guarantees at the EC level. But eliminating internal barriers is going to mean a further redirection of trade away from traditional suppliers and towards partner EC members, analogous to the redirection that occurred after the initial elimination of internal tariffs.

At this stage it is hard to be precise about the impact on the third world. Firstly, 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.

Macro-economic Effects

The Cecchini Report summarises the Commission's estimates of the impact of the 1992 programme.[1] It asserts that Community economic growth will be spurred by the integration of the market and this will be positive for ldc exports. Certainly where the Community cannot produce goods economically, market integration will lead to 'trade creation'.

However the origin of the increment to the EC growth rate is largely 'trade diversion'. Reduced costs of production and distribution will result in an improvement in the competitiveness of EC-produced goods and services and so a redirection of demand from suppliers outside the Community to suppliers within. The third world as a whole should benefit from lower prices for manufactured imports. More critically, whether there is to be a net boost to their economies from increased exports will depend on the balance of trade creation and trade diversion.

For mineral and agricultural raw materials which cannot be produced in the Community, trade creation will be dominant. However demand for primary commodities does not respond as much to increases in income as does demand for manufactures. A 1% rise in EC income will stimulate roughly a 1% rise in ldc primary commodity exports, including mineral oils. Cecchini argues that the 1992 programme will boost EC GDP by 4.5% to 7%, depending on the accompanying policies adopted by the member states. Taking that range would only imply a direct boost to the primary commodity exports of the third world of Ecu 2.8-4.3 bn.

The Commission estimates the direct effect of the removal of barriers as a reduction in manufactured imports of some 10%. Extrapolating to take account of economies of scale and other industrial rationalisation on the basis of the Commission estimates of growth effects, this should be raised to 12%. Taking an elasticity of 2, the trade creation effect of ldc manufactured exports of, say, a 5% increase in Community

Box 1: Completing the Internal Market

The origins of the 1992 programme lie in the paralysis of the integration process in the 1970s. The 1957 Treaty of Rome established the goal of a common market. In practice, although internal customs duties have been eliminated, many administrative barriers to trade between member states remain. Efforts to eliminate these have been piecemeal and have 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 has 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 that goal.

The White Paper distinguishes three sorts of barriers: physical — internal frontiers, customs checks and immigration controls, which, through delays and administrative requirements, impose additional costs on trade within the Community; technical — different national requirements for goods or services, justified on health, safety, environmental or national security grounds; and fiscal — differential rates of indirect taxes levied by the member states.

It put forward some 300 legislative proposals, since refined to 279, and set out a comprehensive timetable for legislative action to eliminate the barriers. The passing of the Single European Act means that, for many decisions, the unanimity requirements of the original treaty are replaced by qualified majority voting by the Member States.

As regards technical barriers, only the adoption of the principle of mutual recognition makes the timetable feasible. In general, any good or service which can be produced or marketed according to the rules of one member state will be acceptable in all. Where there are health, safety or environmental issues, the Council of Ministers indicates essential requirements but not the detailed specifications as in the past.

Status of Implementation of White Paper on Completing the Internal Market (mid-1990)

Proposals adopted by Council	140
Proposals awaiting Council Decision	139
Total	279
Requiring legislation in the member states	107
Legislated in all member states	20

1. Paolo Cecchini, *The European Challenge: 1992*, Gower 1988. For more detail see *The Economics of 1992* (European Economy, 35, Brussels, March 1988).

GDP would be 10% which is not quite sufficient to offset the trade diversion. In services, trade creation mainly through increased demand for tourism owing to higher incomes in the EC will more than offset diversion in transport and financial services.

There will also be terms of trade gains for ldcs. They will benefit from higher prices on the world market resulting from increased EC demand, and, to the extent that lower production costs in the EC are passed on, through lower prices of EC manufactured exports to the ldcs.

However all this ignores the diversion of direct investment from the third world towards the EC by both EC and other multinationals. This diversion will be motivated by the cost advantages of producing within the integrated market, by competition among member states for direct investment and by fears of EC protectionism. It will exacerbate the third world's problems of access to international risk capital and up-to-date technology and reduce its competitiveness in manufactured goods.

Effects of Eliminating Article 115

Those elements of national (member state) protectionism permitted under Article 115 of the Treaty of Rome (see Box 2) are due to be eliminated under the 1992 programme. The quantitative restraints (QRs) on imports must be separated into those established under the umbrella of the MFA and the accretion of other QRs which have been set up independently by the member states, in some cases before they joined the EC.

The Multifibre Arrangement: Traditionally the production of clothing and textiles has been the entrée into manufacturing for developing countries. However this route has long been narrowed by the MFA through which the Community, the United States and most other developed countries regulate ldc imports to protect their domestic industries. The Community MFA is particularly complex in that the 368 EC quotas, covering 17 ldcs and 5 centrally planned economies, are each subdivided into member state quotas.

The future of the MFA is closely bound up with the Uruguay Round of trade negotiations. The textiles negotiating group is to propose ways of bringing these products back under GATT. The Community may insist on selective safeguard mechanisms to control 'market disruption' of imports from specific countries. In any event the reintegration of these sectors into the GATT cannot be achieved before the current MFA expires in mid-1991.

Under the next arrangement, EC quotas are likely to be retained while member state quotas are abolished. If this were done without adjustment, it would mean some liberalisation, since each exporting country could exploit its quotas more intensively. At present, certain member state quotas remain underutilised, but the unused portion cannot be transferred to a member whose quota is filled. However not all the exporting countries are now constrained by quota for all MFA products. Thus in some cases an EC quota would be introduced where one did not exist in the past. Moreover if the Commission were administering the quotas, they might be more strictly enforced than at present.

The World Bank has estimated the average quota utilisation rate in 1987 at 82%, up from 68% in 1983. Given the inevitable mismatches and inflexibilities, a utilisation rate of 90% is about the maximum that could be reached through eliminating member state quotas. In 1987 this would have meant additional EC imports of textiles and clothing from the ldcs of some Ecu 850m. It would have implied a rise in total imports of MFA products of 4%.

However, competition to supply the currently quota-restricted markets will be acute. Most dominant exporters, particularly the NICs, now face relatively high unit labour costs. Certain Asian countries, including India, Indonesia, Pakistan, the Philippines and Thailand seem best placed to expand their exports of MFA products.

Other Quantitative Restrictions: There is no authoritative list of member state QRs, although for the surveillance or suspension of intra-Community imports under Article 115, QRs have had to be approved by the Commission. Some of the industry-to-industry arrangements, such as that between Taiwanese exporters and the British footwear industry, may not even be known to the member state governments. Other QRs, though not formally revoked, may no longer be constraining.

The Commission suggests that many QRs can simply be abolished because the EC industry could withstand the extra competition, at least after further restructuring. This is consistent with the halving of applications for Article 115 over the last ten years. However this reduction may partly be the result of third countries realising that the transhipment of their exports through other member states will be frustrated, particularly since member states may now apply to the Commission for authorisation to submit goods with QRs to 'surveillance'. Table 1 gives a list of recent non-MFA manufactures subjected to Article 115 restrictions.

Ldc exports for which Community QRs appear most likely are footwear and consumer electronics. Replacing existing bilateral quotas by EC quotas would generally mean an extension of protection, since imports into all twelve member states would be covered. Footwear imports from the Republic of Korea, Taiwan and China are subjected to quotas by various member states. S. Korean footwear is constrained by France, Italy and Ireland and Taiwanese footwear by the same member states plus Greece, and, informally, the U.K. In 1987 S. Korea and Taiwan supplied 33% of Community imports but in the sensitive category of sports shoes, where imports have been soaring, they accounted for 65%.

The Commission has recently undertaken a safeguards investigation into the growth in footwear imports from Taiwan and S. Korea. A Community VRA, restricting imports to the EC as a whole, may be proposed for each of these countries. A quota restricting Taiwan and S. Korea to, say, their average 1981/82 import volumes would imply 50% and 41% cuts from 1987 levels, and a loss of Ecu 170m and 89m respectively in export earnings. However EC industry representatives argue that quotas must be placed on all Far East suppliers, since Taiwan and S. Korea are already establishing plants in Thailand and China to circumvent existing restrictions. The major beneficiaries of VRAs would be Italy followed by Spain and Portugal. Among third countries India and Brazil would gain, as would the United States and Hungary.

Ldcs as a whole should benefit from the abolition of QRs on horticultural and fishery products, though countries with preferential access will face tougher competition. Morocco, Burkina Faso, Senegal and Kenya will lose their privileges on the green bean market in France but benefit from the elimination of the Greek QR. Cyprus, Egypt and Chile are constrained by the widespread QRs on potatoes and table grapes. Côte d'Ivoire and Senegal will lose special access to the French markets for pineapples and tuna but Kenya, Costa Rica, Mauritius and Thailand will gain.

Antidumping actions may also become more frequent with the elimination of recourse to Article 115. Antidumping duties have been imposed on steel from Brazil and Mexico, S. Korean video cassette recorders and paint brushes from China. Cases are often resolved with the exporting firm agreeing to maintain export prices at a certain level. Sometimes the threat of an antidumping cases is sufficient to obtain an agreement. Now rules of origin are being used to extend antidumping provisions to firms producing in the EC or third countries.[2] This could deter firms in the NICs producing, for example, toys or electronic goods in other third world countries for export to the EC.

Bananas present a special problem for the elimination of Article 115. At present 40% of the Community's consumption of bananas comes from the ACP and the EC overseas

Box 2: Treaty of Rome, Article 115

"In order to ensure that the execution of measures of commercial policy taken in accordance with this Treaty by any Member State is not obstructed by deflection of trade, or where differences between such measures lead to economic difficulties in one or more of the Member States, the Commission shall recommend the methods for the requisite cooperation between Member States. Failing this, the Commission shall authorise Member States to take the necessary protective measures, the conditions and details of which it shall determine ...

In the selection of such measures, priority shall be given to those which cause the least disturbance to the functioning of the common market and which take into account the need to expedite, as far as possible, the introduction of the common customs tariff."

2. For more details, see Michael Davenport, *The Charybdis of anti-dumping: a new form of industrial policy*, RIIA Discussion Paper No.22, 1989.

Table 1: Ldc Manufactures subject to Article 115 in 1988 and 1989 (first 7 months), excluding MFA

EC country	Product	Exporting countries
Import limitation		
France	Footwear	Taiwan
	Slippers, toys	China
	Umbrellas	Taiwan, Singapore, China
	Car radios	S. Korea
	Televisions	S. Korea, Taiwan
Italy	Footwear	S. Korea, Taiwan
	Silk	China
Spain	Umbrellas, slide fasteners	Taiwan
	Tools	China, Taiwan, Hong Kong
	Sewing machines	Brazil, S. Korea Taiwan
	Televisions, video recorders, imitation jewellery, cars	S. Korea
Surveillance*		
Belgium	Brooms and brushes	China
France	Footwear, televisions	China
	Umbrellas	S. Korea, Taiwan
	Radio aerials	China, S. Korea Taiwan
Greece	Electric motors, batteries electric transformers, toys	Taiwan, Hong Kong
Ireland	Footwear	Taiwan
	Tableware	China
Italy	Silk	China
	Slide fasteners	Taiwan
U.K.	Leather gloves, footwear, tableware, colour televisions	China

* excluding surveillance allowed to Spain and Portugal under transitional arrangements. Surveillance typically implies a system of import licensing.
Source: Commission reports.

territories, the Canaries, Madeira, Guadeloupe and Martinique, with the rest mostly from Central and South America. The former enters the Community under special arrangements designed to preserve traditional markets in Britain, France, Italy, Spain and Greece. For a number of the benefiting countries, bananas constitute a significant share of total merchandise exports — Guadeloupe and Martinique 50%, St. Vincent and the Grenadines 40% and Somalia 20% — with the Community accounting for all (Martinique, Guadeloupe) or over 90% (St. Vincent, St. Lucia) of their banana exports.

Official commitments to maintain the advantages enjoyed by the traditional suppliers after 1992 have been re-iterated, but, given their scale of production and the nature of the land, the 20% EC/ACP tariff preference will not enable them to compete with the large plantations of Colombia, Ecuador and Central America. There may be some scope for increasing production through plantation technologies and marketing; further attempts at diversification can be made. But direct compensation beyond the scope of Stabex is also likely to be needed for the ACP states (and subsidies for overseas territories) for their loss in earnings.

Harmonisation of Tax Regimes in the Community

The proposal is that all member state VAT and excise tax rates should lie within agreed bands. Excise taxes will be limited to alcoholic drinks, tobacco and mineral oils. Thus excise taxes on coffee will have to go. In some member states these are substantial, reaching 41% in Germany and 15% in Denmark, so that there will be important consequences for ldcs' exports, even though demand tends to be rather insensitive to price. It is estimated that abolishing excise taxes on coffee would lead to a 7% rise in Community imports, a 3% increase in world prices and an additional Ecu 398m in earnings on coffee exports to the Community.[3] All exporting countries would benefit, with Brazil, Colombia and the Côte d'Ivoire the main gainers. Eliminating excise taxes and setting an average VAT rate of 5% on cocoa would generate additional imports of about Ecu 50m. The elimination of excise taxes on bananas in Italy will help Somalia, if it continues to supply the bulk of the Italian market.

Tobacco is a special case. Duties on cigarettes in the most popular price category range from Ecu 0.12 in Spain to Ecu 2.76 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 EC average. Instead, excise rates will gradually be harmonised upwards with negative consequences for tobacco exporters in the third world. If, for example, tax rates were to be aligned on the average of the four states with the highest rates, the EC average tax would almost double, implying a 40% rise in prices. This could mean a reduction in EC imports of between 10 and 15% and a loss in ldc export earnings of Ecu 50-80m (based on 1987 imports). Brazil, Zimbabwe, India and Malawi would bear 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.

Approximation of Technical Standards

Fears have been expressed that certain ldc exports will be unable to meet new EC standards which may be higher than those currently in force in certain member states. Most of the proposals concern manufactured goods or financial services which are not significant ldc exports. Toys are an important export for South East Asia, and these will be 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 EC producers are better placed than the outsiders.

Most EC standards on animal and plant health and related public health matters have already been implemented. Where directives are still in the pipeline, it is unlikely that the ldc exports as a whole will suffer but individual countries could have problems. In the case of meat products tighter on-site inspections of plants and slaughterhouses in third countries may create problems for a few African countries. Directives on fish are being drawn up which may pose a threat to Asian and African exports of shellfish and canned fish. Generally, where certification of freedom from disease of herds, processing facilities, or waters in the case of fish, applies, there is always the danger that higher standards in practice, if not formally, will be required of third countries.

For most products the 1992 requirement is mutual recognition. Domestic producers are not subjected to testing or certification procedures, and exporters from outside will only have to satisfy the requirements of one member state: any tests they are subjected to and certificates of conformity will be valid throughout the EC. However, in many cases outside producers will still be required to obtain those tests and certificates and, in the process, could come up against delays and bureaucratic harassment.

Trade Finance and Tied Aid

Export credit insurance: At present each EC state has its own export credit agency. The countries for which insurance is made available, together with the credit limits, depend as much on political ties and historical associations as on credit risk. Each member state only provides insurance for its own exports, excepting small subcontracts in other Community countries.

The wholesale replacement of the existing agencies by a single Community agency has been ruled out. Eliminating national discrimination, so an exporter from any member state could apply to any of the Community agencies for insurance, runs up against existing government subsidies. Some scheme for cross-subsidisation may be worked out. It would be in the interest of the ldcs if the new arrangements helped EC companies from different member states collaborate in

3. For details regarding coffee, cocoa and tobacco, see Michael Davenport, *European Community Trade Barriers to Tropical Agricultural Products*, ODI Working Paper 27, 1988.

Table 2: EC Imports of Selected Commodities from ldcs[a] and Estimates of the Impact of 1992

	Imports from ldcs Ecu m.	ldc Share in EC imports%	EC imports as % ldc expts	1992 effect Ecu m.
	1987			
Textiles[b]: member state quotas abolished	10571	50.4	19.0[c]	846
Shoes: VRA on S. Korea and Taiwan	2410	56.7	49.1[d]	-259
Coffee and Cocoa[e]: EC excise taxes abolished, 5% VAT	5768	98.8	44.6[f]	448
Bananas: protected markets guaranteed	1392	100.0	35.6	-
Tobacco: tax rates harmonised upwards	1969	54.2	44.9	-65[g]
Net trade creation/diversion				
merchandise	106706	18.6	26.4	1583
services	22710	na	na	1227
Terms of trade effects				2521
Total				6301

a: UNCTAD definition plus Taiwan, China, N.Korea, Mongolia and Vietnam, less Libya, Saudi Arabia, Kuwait and the UAE; b: Products subject to MFA; c: 1985; d: all leather goods; e: including cocoa products; f: beans only; g: mid-point of text estimate.

1 Ecu = £0.67 = $1.10 (average 1989)

Sources: UNCTAD, Handbook of International Trade and Development Statistics; FAO, Commodity Review and Outlook; Eurostat, External Trade Statistics; EC Commission, The Situation in the Textile and Clothing Industries.

investment projects.

Tied Aid: A single trading bloc suggests that, if aid is tied, it should be tied to EC exports rather than to the exports of individual members. 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 third world. 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. Taking this percentage and assuming that gains of the order of 20% to the recipient countries from being able to buy from the cheapest Community source, the increment in the value of that aid in 1987 would have amounted to $1.6 bn. 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.

External Trade Policy

EC ministers and Brussels commissioners have dismissed a 'Fortress Europe' as 'unthinkable', but, 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 means that overt moves towards increased protection by the Community would threaten these negotiations and be strongly resisted both inside and outside the Community.

However, on the micro-economic level there is always the temptation to shift the burden of adjustment onto imports. Integration will accelerate the process of structural change through the loss of Article 115, through increased labour mobility and through broad industrial rationalisation and relocation. The 1992 programme could well be used as a rationale for restricting competition from outside. Commission officials have stressed that third countries will benefit from the creation of the internal market and are expected to undertake 'reciprocal' action to open their markets to Community exports.

The EC has made extensive use of instruments of selective import limitation. These have the advantage that they can be applied without legislation or much public scrutiny. EC industry will continue to press 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 recent spate of antidumping and safeguards investigations suggests that this may have already be happening. The pressure will not end on 1 January 1993. When a Community industry is in trouble, the temptation will be to put the blame on imports from third countries.

A Shot in the Arm or a Stab in the Back for ldcs?

Based on this Briefing Paper's policy assumptions for the implementation of the 1992 programme, the net effect on ldcs as a whole is likely to be slightly positive. This is not to say that all developing countries will gain. The poorest economies in the least buoyant shape will not clearly benefit — unless they gain from exporting presently dutiable tropical beverages (commodities which are currently severely depressed).

Table 2 gives broad estimates of the impact of 1992 for the most affected products, based on the policy assumptions discussed earlier, and for the general trade effects. These estimates amount to some Ecu 6bn — equal to 6% of total ldc exports to the Community. But this is only ¼% of third world GDP. Of course the 1992 programme will have an impact on a much wider range of ldc exports but the effects are likely to be smaller and largely offsetting.

Cecchini's 'shot in the arm' might be more substantial if the completion of the market not only leads to a once-and-for-all boost to Community GDP but, through an intensified flow of innovations, new processes and new products, to a higher long-term EC growth rate. The key factors in the long term will remain the relative strengths of trade creation and trade diversion and the willingness of the Community to accept the additional adjustment implied by competition from lower cost producers in the third world.

Glossary

ACP: The 68 (soon to be 69) African, Caribbean and Pacific countries, associated with the European Community under successive Lomé Conventions.

Article 115: The article in the Treaty of Rome through which the Commission authorises a member state to restrict free entry of goods from other member states where those goods originate in a third country, and where transhipment would circumvent quotas.

Dumping: Price discrimination in favour of export sales. Under GATT it may be countered by an equivalent duty. Frequently antidumping actions result in export price or quantity agreements (see VRA).

MFA (Multifibre Arrangement): A series of detailed quota arrangements (from 1973 onwards) which restrict the growth of exports of clothing and textiles from the ldcs and Eastern European countries to the industrial countries.

Uruguay Round: The multilateral trade negotiations currently being undertaken under the auspices of GATT. Initiated in 1986, they are due to conclude at the end of 1990.

VRA (voluntary restraint agreement): Bilateral agreement between an exporter (firm or country) and an importing country limiting exports of a given product.

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