

Langhammer, Rolf Johannes

Book Part — Digitized Version

European economic integration and its impact on future economic relations with Korea: Where do we go in the 1990s?

Provided in Cooperation with:

Kiel Institute for the World Economy – Leibniz Center for Research on Global Economic Challenges

Suggested Citation: Langhammer, Rolf Johannes (1991) : European economic integration and its impact on future economic relations with Korea: Where do we go in the 1990s?, In: Young, Soogil Kang, Moon-soo (Ed.): The single European market and its implications for Korea as an NIE: papers and discussions from a joint KDI-FES conference, Korea Development Institute, Seoul, pp. 236-258

This Version is available at:

<https://hdl.handle.net/10419/1868>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

EUROPEAN ECONOMIC INTEGRATION AND ITS IMPACT ON FUTURE ECONOMIC RELATIONS WITH KOREA: WHERE DO WE GO IN THE 1990s?

*Rolf J. Langhammer**

I. Deepening Integration Through the EC 1992 Internal Program: The Starting Point

The European Community by its nature and history is a trade-discriminating arrangement and this will last beyond 1992. An external wall separating non-member countries from member countries in merchandise trade will remain even if the Uruguay Round should succeed, as it can be expected, to lower the external protection rate. As far as merchandise trade is concerned, the few industries which were still under national domain by the end of the eighties, mainly the automobile sector and some textiles, will be integrated into the common external trade policy, be it in 1992 or somewhat later. At the same time, preferential tariff treatment will be extended to Eastern Europe, very likely with no major impact on trade flows as numerous investigations on tariff preferences have convincingly shown.

All this may be relevant for individual suppliers from privileged countries at the margin, but as the various contributions in the Conference made clear, it is not the major aspect of the internal market program. Instead, the liberalization of factor movements and non-factor

* Institute für Weltwirtschaft an der Universität Kiel

services, the lowering of all sorts of transaction costs within the Community and the changing nature of discrimination against companies rather than against countries are the issues to which an NIE like Korea must find answers. If competition for risk capital and knowledge from both local and foreign sources determines future economic growth as well as bilateral trade flows—and there is ample evidence from the theory of multinational enterprises that this is crucial—the question arises how EC 1992 changes the conditions of competition.

Here are some features of changing conditions:

- 1) EC 1992 has a component of regional policies, that is the Structural Fund in favour of backward areas. The doubling of the fund meant a compromise to claims for more balanced economic growth among member countries and arose from the fear that the removal of barriers to trade, investment, services and personal mobility at least would not be inducible to lowering existing imbalances in the level of income between the periphery and the centre. Regional subsidies, however, are capital subsidies and distort the competition between EC hosts and non-EC hosts. In doing this they may support the trend which was strong during the entire decade: the shift of EC risk capital from developing countries to countries like Spain and Portugal. For instance, during 1980 and 1988, the increment of West German FDI in manufacturing was larger in the two countries than in all developing countries including the NIEs.
- 2) Liberalizing services in those sectors like air transport where national vested interests are traditionally as strong as the lobby groups will first of all open the scope for EC-based companies. For instance, under the EC step-wise program of intensifying price and capacity competition in air transport, cabotage (transport on national routes) may finally be opened to all EC-based carriers but most unlikely to non-member carriers. Hence, serving a route Hamburg-Munich is no option available to Korean Airlines under the EC 1992 program.
- 3) EC 1992 will incorporate further subsidies to Community-wide R&D. EC-based companies are encouraged to economize on expenditures for R&D by pooling resources and this may be an

important incentive to overcome the narrow horizon of national companies which still prevails in the Community.

- 4) Human capital formation on a Community-wide level has been given high priority by the EC Commission. Programs like ERASMUS, Science and Spes provide incentives for common training and research programs between EC scholars and research institutions in natural sciences, economics and social sciences. Third, countries are not principally excluded from funds but their access is limited to such research programs which are hoped to strengthen the European scientific potential. It goes without saying that there are externalities in promoting scientific co-operation which are available to third countries too as research personnel is relatively mobile. However, particularly in basic research the competitiveness of the European location relative to the US and other research bases will gain momentum if barriers to transnational exchange of knowledge are eroded by such programs.
- 5) In future, European competition policies will become more important relative to European trade policies. The argument underlying this hypothesis is that EC 1992 will influence the ranking between direct investment and direct exports to the favour of the former alternative and that competition policies have an impact on investment flows while trade policies control flows of goods. The location of investment is mainly determined by the price of non-tradeable goods and services including institutional regulations and this price is also the key instrument of competition between countries. Should the country of origin principle, in other words the ex-post harmonization principle, dominate over the country of destination principle (ex-ante harmonization) as the Commission propagates, non-tradeables will face competition and the law of one price will increasingly become relevant for non-tradeables. Under these auspices market forces will induce EC member countries to withdraw from excessive regulation but this still leaves the question of competition among multinational actors open. As the first-best solution (no discrimination between EC- and non EC-based firms) conflicts with the existence of the European Community, EC com-

petition policies become the second-best instrument. Whether the new competence given to the Commission will be a powerful tool to discourage concerted actions and cartel behaviour or whether it will be abused for industrial targeting cannot yet be answered. In any case, as in many other fields, here the Community is at the cross-roads.

- 6) From the very beginning, European economic integration was perceived as a vehicle toward stronger political interdependence. Should interdependence arise from competition rather than from cartels, international collective goods like stability and foreseeability in the multilateral trading order and the international monetary order could be produced. If not, then we would see the ongoing pattern of trilateralism.

II. Widening Integration: The European Economic Space

What characterizes the widening of integration beyond EC-12, did not received much attention in the Conference. This is understandable as it is—apart from EFTA-EC relations—a recent phenomenon which is not yet clear in its scope and implications.

As far as EFTA-EC integration is concerned, the so-called four freedoms of establishment, persons, goods and services which characterize the EC-1992 program will be applied (except for few issues of national interest such as the Swiss regulations of guestworkers).

East Germany is going to be fully integrated into the Community by the process of merging with West Germany.

Eastern European countries will link either to EFTA or EC countries but how strong this link will be mainly depends on the progress of market-oriented reforms in the individual countries.

What can be expected in the short run is that reforms will be subject to inertia simply because private agents trained in socialism will not immediately be prepared to accept market forces to be dominant in all sectors, including real estate and the public service. Bureaucracies in Socialist countries are also powerful lobby groups against the opening

of markets. The familiar pattern of protection of privileged factors of production dominating over the protection of consumers is likely to be valid in eastern Europe too. Under these circumstances, the fear of rapid diversion of investment flows towards Eastern Europe and the loss of EC markets due to unilateral tariff concessions for Eastern European products does not seem to be very relevant, at least not for the near future. Risk premia are still high in investments in Eastern Europe even if they are mitigated to some extent by state guarantees.

Yet, increments in investment may shift in favour of the Eastern European countries in the medium run if the opening of markets goes beyond lip services and if reforms gain credibility thus raising the real rate of return.

For Korea which is not an important host of foreign direct investment, the impact may be mainly felt on international capital markets which may honour credible reforms in Eastern Europe.

III. Lessons for Korea

Both, the papers presented at the Conference and the contribution of the discussants, suggested that the interest of Korea in the process of European integration is still very much influenced by traditional merchandise trade and its growth potential rather than by capital transactions and trade in services. We found three major reasons for this.

First, Korea is not yet a major supplier of services apart from merchandise trade-related services (e.g. maritime transport). Nor is it a prominent exporter of capital. Should, however, Korea proceed to open its financial market as scheduled, the focus is likely to shift slowly towards business services like banking and insurance.

Secondly, geographical remoteness matters. It matters not only in terms of intensity of bilateral trade relations but also with respect to the structure of trade. For instance, consumer services which require inter-personal contacts still suffer from relatively high transaction costs and so do service-intensive goods which require networks of after-sales services. In these sectors, Korea is primarily linked to the Pacific

rim and this area will remain its largest sales and input market.

Thirdly, among the four Asian NIEs Korea was shown to be the most advanced country in mass production of consumer durables and increasingly capital equipment. We heard that the European automobile market will become a target of Korean producers in the next years. Additionally, telecommunications equipment will be a promising market if national PTTs in EC member countries allow for free competition in the market for terminals as it happens in West Germany, for instance.

Yet, as advanced industrial goods are service-intensive, exporting such goods on a large scale will require lump-sum investments in service networks in the Community as well as in R&D. Thus, Korean companies might increasingly be interested to enter into joint ventures with European partners who could share financial burdens and would also be familiar with the market.

To conclude, both the completion of the internal market and the advancement of Korea's production scale will give rise to reconsider the choice between direct exports and foreign direct investment. Until the end of the eighties this choice was clearly in favour of direct exports but is expected to shift gradually towards production in former export markets. This shift will occur even if the level of external protection in the EC should decline and even if there would be no "local content" threat.

IV. Asia-Pacific Co-operation as a Defensive Answer to EC 1992?

"Fortress Europe" labels seem ineradicable. They are prominent in Asia in general and were reconfirmed in many papers and discussions for Korea in particular. It would go beyond the scope of a wrapping-up paper to confront this perception with reference levels like protection rates in the US and Japan, with growth rates of Korean exports to the EC (in spite or because of protection?) and with protection rates varying by sectors and individual EC member countries.

Doubtless the EC pursues the largest number of preferential arrangements compared to the US and Japan and has always insisted on the right to apply safeguard protection on a selective basis, and it is probably this heavy reliance on trade-diverting special relationships which has contributed to produce this label.

Several scholars in the Conference showed some sympathy with Asia-Pacific Co-operation as a final defensive answer to EC 1992 should the Community market be "closed" (whatever this would mean). Apart from doubts whether Asia-Pacific could compromise on a common position, the question arises whether aggressive reciprocity and retaliation would be helpful to open the EC markets or whether it would fail but provoke counterretaliatory actions. In view of the fact that Asia Pacific (excluding the US) is neither a major export market for the Community suppliers nor an important sourcing market I would doubt that the leverage is strong enough. It is more likely that costs for Asia-Pacific would be high in terms of income foregone apart from external costs as for instance torpedoing the multilateral trading system.

More and better enforceable sanction mechanisms in the GATT, more binding procedures for dispute settlement, trade-related investment measures and finally ongoing liberalization in Asia-Pacific as an important bargaining chip would be more effective strategies against a fortress than retaliation.

Without internal benefits to be gained by all partners from Asia-Pacific Economic Co-operation, such co-operation would at worst collapse, at best stagnate.

V. Micro- versus Macroeconomic Views on EC 1992

Necessarily, a conference dealing with bilateral economic relations between an NIE and the Community prefers a microeconomic view by analyzing market prospects sector by sector and industry by industry. Under this umbrella, it may be difficult to escape from the fear that artificial barriers which are built up by the Community in goods markets in the past will be proliferated to services and capital

transactions.

Yet, this is not the relevant yardstick especially not for Korea which permanently rationalized and upgraded its export supply and domestic production in the past.

EC 1992, if it is based on the origin country principle, offers similar changes and impulses to the world economy. It will not only fuel demand for traditional imports because of higher growth or shift trade flows because of changing relative prices. Primarily, it will promote product innovations and competition between hosts apart from process innovations as a result of economies of scale.

Empirically oriented economists always fail to assess such dynamic medium-term effects correctly in quantitative terms and thus tend to give undue weight to sectoral static trade effects (trade creation versus trade diversion), changes in terms of trade and income effects which are all small. The Cecchini Report was no exception to this rule.

EC 1992 may be much more instrumental to create knowledge and new skills in a supra-national perspective which is essential to tackle regional and global issues like environmental protection and worldwide population pressure. It can reconcile private globalization with international public services. A country like Korea which is prone to long-term economic perspectives will find such visions appealing and challenging.

COMMENTS

Won-tack Hong

First, I'd like to make a comment on the Koopmann-Scharrer paper. I do agree with the authors' belief that the future dynamism of the European economy as well as the future dynamism of the entire world economy depends on the openness of the EC market. I also agree with their belief that the EC's competition with Japan, the United States and the NICs would be essential for the long-term growth performance of the Korean economy. Indeed, the European Council, as the authors note, declaimed that Europe of 1992 will be a partner and not a fortress. It also declared that the European internal market will be a decisive factor contributing to a greater liberalization of international trade. Unfortunately, most people in the rest of the world do have a very uneasy feeling, and most people in the rest of the world are quite worried about the possible prospect of undesirable developments—accelerated regionalism and protectionism.

I think the question is now how the rest of the world can induce the EC countries to reverse their inward looking tendencies, and how the rest of the world can help the EC to enhance open competition. As the authors indicate, on the completion of the European Internal Market, the EC obtains very enhanced bargaining power vis-a-vis the fairly disorganized US, Japan, and Asian NICs. At the same time, the authors call our attention to the increasing subordination of EC trade policy to its targeting policy, in the form of state subsidies cum cartel arrangements. It seems that perhaps the most efficient way to produce and reverse inward-looking protection tendencies in the EC might be to form a Pacific Basin bloc including the United States, Japan, Canada and Asian NICs, with the sole objective of forming a counterbalancing force against any possible undesirable developments in the

EC. For instance, the EC has set forth the commencement of the European internal market in 1993 and the Pacific Basin countries may well announce the commencement of a kind of Pacific Internal Market in say 1998, five years later. Clearly, the EC must be reminded that there are important regions other than Western and Eastern Europe in this world and that the EC must take into account the existence of the rest of the world in order to maximize the growth potential of the EC as well as of the whole world. Particularly from the viewpoint of Korea, since the developing countries like Korea have very little bargaining power at all, it might be to the benefit of these countries to push an idea like the formation of a counter-balancing bloc in the Pacific area as a means to avoid unfavorable bilateral arrangements with the unified EC.

A second aspect or point is that the European Internal Market Program includes the removal of internal barriers and harmonization and mutual recognition of industrial standards. Until now, the rest of the world has often tried to circumvent the national restrictions of individual EC member countries through indirect shipments by way of neighboring EC countries, and in doing so, observed their merchandise being rejected at the internal EC border. The authors asked whether the removal of national trade restraints and the law of one price would make the member states, as a whole, less protectionist against third countries than is the case today. After all, the EC Commission announced that most national quantitative restrictions on imports would be removed by 1992. In theory, as the authors say, the uniform EC protective system would make prices in hitherto national markets rise, while the prices would decline in those markets that have been heavily protected on a national level. But the authors are still quite worried whether, since the administration of quotas will remain in the hands of national customs authorities, and since the restrictive business practices by national importers' organizations will continue, it will be possible for the EC to have a true common market. At this point, I wish the authors would spell out more clearly what bothers them, what are the possible factors in each national market, and possible entry barriers against outsiders in each national market that would make it difficult for the EC to achieve a true common market after 1992.

Another point is that the authors suggest adjustment assistance for declining industries, as well as high-tech industries, possibly financed from the proceeds of import restrictions, as indicated on page 10-5. They believe that such a financing arrangement will make protection a transitory phenomenon. The problem is that their suggestion, financing their adjustment assistance for declining industries with the proceeds from import restrictions, is contradictory to the textbook case for the best policy, and I cannot see why such a financing arrangement will make protection a transitory phenomenon. They also mention a more "enlightened" national public in their argument for selected safeguard actions. But they say these are optimistic expectations. Any argument based on such an illusory phenomenon as "a more enlightened national public" might have to be regarded as unrealistic rather than optimistic. Also, I'd like to know why the authors believe that their selected safeguard actions would be exposed to closer multilateral monitoring than bilateral arrangements.

Now I turn to Dr. Kim's paper. I gained a lot of information on Korea-EC trade in the first part of the paper. Now I move to the second part of the paper. Dr. Kim mentions that the existence of barriers which fragment the EC market is an obstacle to competition which reduces economic efficiency. Differences in the price of a given product, from one country to another, are a particularly useful indicator in this respect. Dr. Kim also mentions the law of one price and also the price dispersion of an identical sample of a durable good across the country. He mentions all these things, but then he wants to test the hypothesis based on the assumption that consumers in the high-income states will demand high-quality apparel, compared to those in the low-income states, and this hypothesis is not rejected. I find some inconsistency between the initial statements concerning the law of one price and the regression analysis that produced a positive correlation between GNP and the unit export price of wearing apparel. Another confusion is that I thought they were regressing in terms of per capita GNP, rather than aggregate. Dr. Kim's findings do not seem to have anything to do with the law of one price or inefficiency. It might indeed simply reflect that consumers in high-income states demand differentiated high-quality products. What is presented here is

not about the law of one price for an identical sample of monitoring. So I got quite confused about this regression.

Ippei Yamazawa

Let me confine my comment to the paper written by Dr. Koopmann. I read your paper with great interest, and I appreciated your paper very much. The paper gave very objective, precise, and rich information about the external trade policy of the European Community. I am very much impressed by your conclusion, with its warning against the obvious tendency of the EC's external trade policy to include an association with industrial policy, especially the promotion of high-tech industries. I have no major questions on technical details, but I have a strong request for you to elaborate upon the last section to include your own policy recommendations. You were excellent in giving a very objective analysis of what is going on, but I would like to know how you evaluate the situation and what your policy recommendation is. I know you are not very happy with the present situation, and you would like to suggest some alternative direction, but it is not very clear in your paper, especially the last part.

Everybody here mostly economists and nonpartisans, shares a common interest, and I think we can be very frank, and so we have a common interest in producing some very workable policy recommendations. But before going into that, I'd like to explain how the Japanese government responded to the EC's trade policy. And later, I will present my own suggestions or policy recommendations.

Although the main theme of this conference is the EC-Korea relationship, many papers, including those of Dr. Koopmann and Dr. Hild, suggested that the many restrictive measures taken by the EC were first introduced against Japan. You pointed out that the EC's restrictive measures are very selective, and you apply those restrictive measures only to those who were competitive enough, like the Japanese, while you are very generous to other developing countries,

or even developed countries who will not be as competitive as European firms. And industry expects that Korea will be the next Japan, so that's the reason why Dr. Young assigned me to explain how Japanese government and business are responding to it. Yesterday afternoon, I explained, in a rather ad hoc way, how Japanese business responded to it, and today I'd like to explain how the government is responding to it.

The Japanese government first responded to the EC's restrictive measures two or three years ago in the form of constant criticism against "Fortress Europe." When I visited Brussels to interview the EC Commission, the man whom I interviewed in charge of the Japan issue complained that whenever Japanese ambassadors in Europe speak out, they always criticize "Fortress Europe," so there must be some instruction given by ambassadors to European member countries by the foreign ministry in Japan. That was the first step, taken two or three years ago. Our government decided not to repeat "Fortress Europe," and they are now responding in a more effective way. That is what prompted MITI's program for international cooperation. It was first designed to be applied not to the EC but to the United States, however, it is equally applicable to the EC. But there are no recent documents on it. If you visit MITI and ask about the program for international cooperation, the MITI officials will avoid referring to it, or they will call it a general guideline. My understanding is based on information or interviews with firms or with industry associations.

Let me describe MITI's program for international cooperation. First, MITI's ministers or vice-ministers, the top-ranking officials in MITI, invite the presidents of major firms to show them what MITI thinks the desirable direction of the Japanese private sector's response to the EC should be. I have no accurate figures, but they say they will cover major firms in automobiles and electronics, which will contact almost 70 percent of exports to the EC and the United States. If the program is effectively implemented, they can expect very significant effects on exports. MITI's international cooperation program consists of three components: one is not to increase exports, restraining them at the present level; second, to increase imports at least up to half of exports; and third, to increase local production, not only assembly production,

but also production of parts.

I may have given you the impression that MITI maintains very strong power in guiding business. But it is an open question. As you know, MITI has no legislative power to guide firms in that direction. MITI has been trying to regain and retain legislative power, but so far has failed, except for some restrictive measures during the first oil shock. But now I think that MITI finally found some good reason for their administrative guidelines. It is in the national interest to avoid trade conflict. And with this excuse, MITI is talking very strongly to major firms. If the firms do not follow their instructions, then they will be acting against the national interest. This is my interpretation, and I am not sure whether it will be effective or not. But so far, the major firms in automobiles and electronics have responded to not only restrictions made by the EC but by the United States in ways that are very consistent with MITI's ICP. It might be that major firms have simply found MITI's guidelines consistent with their interests, and so they follow their guidelines, so long as the guideline coincides with their interest. That may be the most plausible interpretation. But in any case, both government and private major firms are now responding to the EC's external policy. MITI and major Japanese firms are quite uncertain about what the EC's external policy after 1992 will be, so they are now preparing for whatever the EC policies will be, by shifting from export of complete things to assembly, from assembly production to localized full production from the parts supplied.

This is my objective description of Japanese government and the Japanese business sector, although I think that Mr. Koopman described the EC's strategy very beautifully and precisely while I did not describe it in a comparable way. But anyway, I gave an objective description without any of my judgment. I think that it is the first job of an economist to describe what our government and business are doing. But we should not stop here; we should proceed to the next stage, to assess the possible welfare impact of the policies or response by the government.

I think we share many common things. We all know theory, both its strengths and weaknesses. Textbook theory can tell the short-term impact or static impact of many government policies, but does not

tell much about dynamic gains. We are not purists in proposing only one best policy; we are practical enough to be satisfied with second-best or third-best, subject to political pressures or social or cultural constraints. We also are not very happy with the present state. We are not sure whether we are going in the right direction, and I think that is our professional job to warn our public, both in Europe and the world, about the possible adverse impacts of this kind of tendency toward more strengthened, managed trade. I would like to suggest, too, some alternatives—the best policy and the second-best policy. The best policy, of course, is to promote the Uruguay Round of the GATT negotiations and to strengthen the GATT safeguard measures so as to prevent the distorted application of grey area measures. This is the best policy. But with only six months to go until the conclusion in late November or December, we cannot be very optimistic. The safeguard measures will not be discussed in detail until the last minutes of the GATT negotiations, and it is quite possible that the present Uruguay Round will be concluded without any significant progress in safeguard measures. So what can we do? What should we do?

The Japanese government is now making a two-way approach. One is to promote multilateral trade liberalization by promoting the success of the Uruguay Round negotiations. But on the other hand, they are practical enough to respond in a very practical way, urging their business to respond in the direction of strengthened managed trade. This is a two-way approach, but I would say, with more emphasis on the latter. So if the Uruguay Round will be concluded without any progress in safeguard measures, then we have to anticipate that the tendency toward managed trade will be strengthened in the future. What can we do? Dr. Hong suggested the use of a countervailing bloc in the Pacific to persuade the EC towards reducing the multilateral trade restrictions, and we'll have a chance in August in the Pacific, at the PCC trade policy forum in Kuala Lumpur. There we will discuss this kind of thing, find out the common interest in the Pacific, and make the Pacific input into multilateral negotiations, to persuade the EC in that direction. However, I cannot be very optimistic about that.

Seong-lin Na

Before discussing the two papers, I would like to argue that we need to draw a distinction between EC 1992 projects and the EC's building up of tariff barriers against nonmember countries. Many people seem to think that those two are one technique in the process of building up a single European market. However, as far as I know, they are separate processes which are occurring at the same time. As far as EC 1992 is concerned, it is an ambitious project that tries to improve the efficiency of both EC firms and the EC economy, by removing all internal tariff barriers, and thereby creating internal trade and improving the international competitiveness of EC firms, and eventually increasing the EC's welfare. There can be no great objection to that. It may be beneficial for the non-member countries as well in the long run, as the EC Commission constantly argues. On the other hand, the EC's recent reinforcement of nontariff barriers against nonmember countries is not a part of EC 1992 but a measure occurring in parallel with EC 1992, partly in order to protect EC industries, whose integration processes are bound to be slow, and so whose performances are inefficient. I myself have recently estimated the possible impact of EC 1992 on Korean exports to the EC, which, to my surprise, turns out to be rather modest. According to the estimations, the immediate static effect, by which I mean the cost and price reduction effect, of removing all the internal barriers, would reduce Korean exports to the EC only by 2.42 percent on average. Even the long-term dynamic effect, by which I mean the further cost and price reduction effect, with economies of scale and enhanced competition within the community, would reduce Korean exports to EC by less than 6 percent on average. The implication of this result is that the effect of EC 1992 itself would not be as worrying as many people often thought. After all, the integration of the EC market would not be able to achieve the degree of integration that the US market has achieved. However,

even a market as integrated as the US market was unable to produce products cheaper than Korean products, as far as our main export items and the US are concerned. This will be the case in the EC market, I believe. However, the EC's nontariff barriers against nonmember countries, which are often imposed under the name of reciprocity, are a different matter, and seem to be a worrying phenomenon indeed. The declining share of Korean export goods under the EC import restrictions among the total Korean exports to the EC shows this very clearly. Since 1987, according to Korean Foreign Trade Association statistics, these shares have been declining significantly. In 1987, the share of import-restricted goods among the total exports to the EC was 41 percent, but it declined to 33.7 percent, 22.3 percent, and 18.6 percent in 1988, 1989, and 1990, respectively.

There is more evidence which may prove that the EC's imposition of nontariff barriers against Korean export goods is worrying. Professor Allan Winters of Great Britain estimated that 25 percent of voluntary export restraints the UK had imposed against Korean footwear in 1979 had the effect of increasing the export price of Korean footwear to UK markets by a tariff equivalent to 27 percent. This increase in export price, using my estimation model, would reduce the export of Korean footwear to the UK markets by 22.7 percent, even in the absence of EC 1992. This reduction is very much in contrast to the reaction caused by EC 1992 which I quoted above.

The increased number of import restriction measures both EC and non-EC member countries have taken in recent years against Korean export goods also tells us the EC is moving towards protectionism. This is despite the fact that during this period, Korea's market had become more open to EC countries. My argument so far has been intended to show that we need to distinguish between the EC 1992 project itself, and EC's reinforcement of import restriction measures against nonmember countries. Furthermore, what is worrying outside of this to us Koreans is not EC 1992 itself but the EC's buildup of tariff barriers against nonmember countries.

Having said that, I would now like to comment on Dr. Koopmann's paper. This paper is very stimulating because, while in the past few years, most research has been done on what is going to happen by

1992, this paper addresses the question of what is going to happen after 1992, especially in relation to EC trade policy. If one accepts my argument above that what is worrying us is not EC 1992 but the EC's import restriction measures against nonmember countries, then what is more important for us is not what is going to happen by 1992, most of which we already know by now, but what is going to happen after 1992, especially whether EC is going to move towards free trade by abolishing all protectionist measures, or is going to maintain their protectionism. Dr. Koopmann's scenario seem to be suggesting that the EC's trade policy will maintain some degree of the protectionist attitude at least for the first year of its future.

For various reasons, I tend to agree with this scenario. As far as I'm concerned, I see two main problems with the EC's trade policy, especially, import restriction measures. One is the lack of transparency, and the other is the discriminative way it is applied to the nonmember countries. In the future, this policy must become uniform, both internally, across member countries, and externally, across all nonmember countries.

Dr. Koopmann also argues that the third country producers will benefit from EC 1992 mainly due to the growth impact of EC 1992, and the removal of intra-community barriers to trade and uniform norms and technical standards. Yes, this will be true, at least in the long run; however, a benefit will be realized only if the Community entry barriers are fully removed. Dr. Koopmann's recipe of direct investment to overcome this problem is what we Korean government officials and economists have been arguing for the past few years. However, well-informed responses have been rather slow; this is because our firms do not feel that they have any comparative advantage over EC firms in investing in the EC. In order to be successful in direct foreign investment, the investing firms must have at least one advantage in terms of management skills, production costs, marketing, or technology. Korean firms do not seem to have any of them, whereas Japanese firms do. This is why the latter have invested much more than Korean firms have.

Finally, I have one comment to make on Dr. Kim's paper. Dr. Kim tried to explain the export price discrepancy of Korean export goods

with those of EC member countries. I guess that his aim in doing so was to find out whether the high degree of import restriction raises the price of import goods, thereby damaging the interest of domestic consumers in the importing country. The result shows that there is no correlation between the two. However, it seems to me that Dr. Kim's model is perhaps underspecified, as is evident in the value of R^2 . The price of a Korean export good must depend on the market conditions of the importing country, and other countries' export prices as well, apart from the quota utilization ratio. Including additional explanatory variables like these may affect the result. I also do not like the dummies being used for the quota utilization ratio. Would you explain to me why you did not use the value of the utilization ratio itself, instead of using an arbitrary definition of the binding quota?

Frank Holmes

I don't know whether I represent a Pacific view. I'm told that Koreans who have had to struggle over the centuries to preserve their distinctive cultural identity while surrounded by large and powerful neighbors have likened themselves to a shrimp in a sea of whales, which I understand is one of their proverbs. Coming as I do from a country with a population list the net of Pusan, and observing the magnificent economic achievements of the people of Korea since I first came here about 25 years ago, I'm bound to say, "Some shrimp."

Although New Zealand is a long way away from North Asia and Europe, we haven't been and we are not now isolated or unaffected by what they do. New Zealanders have spilled blood in European wars, wars between the United States and it, and even in the Korean War, and we don't want any more of those. We want a world that is solving its problems through peaceful trade and cooperation. That's the theme that I know really actuates this conference.

New Zealand's trade used to be largely based upon selling pasture products, for a number of reasons. Despite a special arrangement the

Community has made in that matter, Britain as a member has had to reduce access for our competitive products substantially. So increasingly, we have had to seek our destiny in the Pacific. About 70 percent of our trade now is done with Pacific partners, and increasingly North Asia, including Korea, provides the fastest growing areas of opportunity for us both ways. But Europe remains very important, having 19 percent of our trade, and more important indirectly in some ways than directly. And we share Korea's keen interest in seeing that the exciting developments now in train there which have been portrayed to us so well here are carried through in a liberal and outward-looking manner, and do not become the cause of a degeneration of the multilateral system into one of warring blocs.

My association with KDI has stemmed largely from our mutual interest in Pacific cooperation and KDI and Soogil Young in particular have played a leading role in the work of PECC on trade policy in particular. One of the features of our work up to now in my view is the virtually unanimous agreement at the PECC and other Pacific meetings that we do not want to work for a restrictive trading bloc. Most of us do not claim to be free traders yet, but many of us are on the way. There has been growing recognition that Pacific cooperation really means an alliance of outward-looking, diverse, and independent nations working actively to lower barriers to trade and investment in the world as a whole. Our highest current priority is a successful GATT Round, and we're concerned at how far apart the major players, Europe, Japan, and the US, appear to be on a number of issues that have to be solved in the GATT Round. But the Pacific bloc of the type that Wontack Hong is recommending is very much a second best in the meetings I go to, and we don't want it. But if we're going to have success in the GATT Round, there must be a package of liberalizing "concessions" (his quotes) by all participants in primary and service activities as well as in manufactured products, in trips and trims, and readiness to give GATT power to act against the misuse of safeguards and other practices against its roles, including the role of nondiscrimination, and to settle disputes effectively. That means readiness on our part to offend some politically sensitive producers, who now enjoy protection or support.

We have been among the highest protectionists of manufacturers in the past. Our government has deemed it politically impossible to get rid of our import licensing system that protected our manufacturers. But increasingly it has become apparent to us that the policies were doing grave damage to our own consumers, our own taxpayers, our own more efficient producers, and our capacity for stable growth. So now, in our own interest, we're on a path of de-protection, deregulation, privatization, reform of the tax system, and reform of the public sector in a radical manner. And I share Professor Yamazawa's hope that the Koopmann-Scharrer paper might perhaps amplify his conclusions by looking at some positive recommendations to deal with the serious issues for international cooperation that it brings out to us. In particular, how will those of you within the Community who believe that things should be done differently create or strengthen institutions and procedures which ensure that you get regular analysis and public discussions, both in your home countries and at GATT, of the costs and benefits of protection, regulation, and support. We need those sorts of institutions established everywhere, I believe, in the circumstances which we're in front of.

Because of the fuss New Zealand makes about butter, we're regarded as rather narrow characters when we come to look at Europe, in particular. In fact, if you read New Zealand government statements, they take a very positive attitude to the desirability of European integration and the development of a single market. And we trust that the Community people are sincere when they say that they're too dependent on external trade to risk the retaliation that would come from greater protectionism. And we have observed in several areas, that they have not been working for the more plenified, harmonized, and protected market that some had feared, that market principles have been prevailing in several areas, and that the concept of mutual recognition does provide some possibility of more liberal access by outsiders, provided that they are adopting an approach of actually reducing barriers externally. But like other speakers, we've got to remain apprehensive that less liberal forces will prevail in some of the as yet unresolved issues of integration, of procurement in direct tax regimes, and controls on the movement of people and the provision of services. Uncer-

tainties remain about the harmonization of regulations, thought too important to leave to mutual recognition, and it is possible that more restrictive national measures could prevail. Perhaps, as Dr. Na said, more important than the single-market issue is what you are going to do about the provision of the common agricultural policy and the common commercial policy, especially in respect of anti-dumping and other safeguards of the CAP. Perhaps inevitably our major disagreements with both the Community and Korea rest in the field of agriculture, but it would not be appropriate for me today to belabor you on New Zealand's approaches. I'm encouraged by Soogil's sensible approach to the future liberalization of Korea's agricultural trade policies, and I hope he applies it to dairy products, where they are both offering and charging prices miles above the world level, and like the Europeans, thereby encouraging diminishing consumption and putting themselves in the position where they want to subsidize exports to the rest of the world. I think a transparency cost-benefit approach to those sorts of things in the European and Korean and New Zealand sectors would be very desirable indeed. And I'm encouraged by the recognition of the German contributors here of the disadvantages of the present methods of trying to help their farmers. We don't expect them not to help their farmers, but there must be a better way, and I would like some recognition made of that. It's not just a matter of agricultural trade that's at stake here, as the German Federation of Industries, in their paper on the position of German industry, say on the main aspects of these external economic policies. Probably the crucial thing is what assistance, with your present attitudes toward export subsidies and market access, will do to the GATT Round, when you have a country like the US and the Cairnes Group, so far apart from that position. And I am running out of time, so I won't quote the BDI, but this could have been written by a New Zealander: "I hope they win in Germany and the Community. Rather than form alliances with those in the Pacific who might want to fight Europe, we would rather form alliances with those in Europe who would like to fight their protectionism and discrimination."

But I think the last part of the paper by Koopmann and Scharrer must cause us some concern at the widening area of discrimination

which is arising around the Community. It is not accompanied by a positive and significant reduction of barriers to access by outsiders. I invite you to read very carefully pages 38 and 39 of the paper about the regional dimension of discriminative elements. It's not good to be at the bottom of the pyramid, if that is going to be accompanied by instrumental dimensions of trade policy which show a propensity to selective gray area arrangements. And we would strongly advocate supporting the Yamazawa line and going for the maintenance of the MFN principle: no selectivity, strict limits on the duration of safeguard action, measures for degressivity and transparency and all that, in the international interest of matters. And further, if the sectoral dimension of trade policy is also going to become more important, then we have real occasion for concern that Wontack Hong will prove to be right, that we have no alternative in the Pacific but to take some defensive discriminative action. I would say to him that that isn't going to be as easy in the Pacific as it might have been in Europe. So my threats might not carry a great deal of weight with the European members. But if a community is to honor its treaty obligation to promote trade between its members and third countries, if it is truly to become a power player and not a fortress, then we must endorse the conclusions of the paper before us.