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19 The EC Single Market and its Effect on Developing Countries

Rolf J. Langhammer

19.1 EUROPE 1992 AND CHANGES IN THE INTERNATIONAL TRADING SYSTEM

Non-EC member countries in general and developing countries in particular have often expressed concern about the completion of the internal market by 1993. Various studies stressing the positive effects of EC integration on economic growth, structural change and import demand could not dissipate the fear that the EC would be tempted to shift parts of the adjustment burden to third countries by building a 'fortress Europe'. This fear is based on an extrapolation of past experience with EC protectionism, and it receives further support from uncertainty about the stage of integration after 1992. There are a number of valid reasons for uncertainty about the future course of EC trade policies:

- The Cecchini Report (1988) as well as the empirical studies presented in the so-called Emerson Report (CEC, *The Economics of 1992*, 1988) focused solely on internal effects and neglected the external dimension.
- Differences in protection levels among individual member countries are still sizeable and there are disputes about the way to achieve a common protection level.
- The effects of liberalising factor movements and trade in services are much less easily predicted than integration effects in the case of merchandise trade (trade creation and trade diversion).

Finally and most importantly, uncertainty is enhanced by the fact that parallel to 'operation 1992' three other operations have to be conducted which will determine the level of market accessibility for third countries. In principle these are independent of the completion of the

single market, but they still have to be seen in the context of the integration process. The three events comprise the completion of the Uruguay round scheduled for the end of 1990, the reform of the GSP after 1990, and the negotiations on principles of trade in textiles and clothing after the expiration of MFA IV in 1991.

In the four negotiation rounds the critical parameters of competitiveness will be determined, that is the changes in relative prices between imports and domestic substitutes. The net outcome is highly speculative since the EC has not yet decided on the future shape of the single market. Therefore an evaluation of the future position of developing countries in this market can only rely on alternative scenarios. Forecasts are not possible given the fact that the core of EC integration will be the liberalisation of services and very little information is available on the initial amount and structure of intra- and extra-EC trade in services.

19.2 EFFECTS OF THE INTERNAL MARKET ON INCOME GROWTH AND IMPORT DEMAND

19.2.1 Income growth

The removal of all physical barriers to intra-EC trade in goods and services, as well as the scale effects of a large single market, are expected to result in added economic growth. Estimates range between an optimistic 4.5 per cent over a five year period (CEC, Economics of 1992, 1988, Part A) and just 2.3 per cent over the same period (Bakhoven, 1989). The only thing these estimates have in common is that they fail to consider the dynamic effects of structural change after 1992 and instead focus on cost reduction only (process innovation). For this reason, 1 per cent added growth per year can be regarded as a rather conservative estimate which may actually be exceeded. 'Normal pattern' estimates arrive at similar results. They measure the relationship between sectoral value added as a dependent variable and per capita income and population as independent variables in a cross-country regression. The difference between the sum of the estimated value added for individual EC member countries and the theoretical value for the EC as a single entity is taken as a proxy for scale-induced added growth. Using a sample of 61 OECD and middle-income developing countries this relation can be described as follows:

$$\log V = -1.146 + 1.033 \log y + 1.178 \log P$$

where V is gross manufacturing value added, y is per capita income and P is population (prices and data of 1986). Inserting data for all individual EC member countries yields a total of \$552 billion compared with \$910 billion for the EC as whole. The difference amounts to 11 per cent of the 1986 GDP of the 12 EC countries or 1.3–1.5 per cent of the estimated annual GDP of the 12 EC countries between 1987 and 1992.

19.2.2 Import demand for manufactures from developing countries

The increase in economic growth following the completion of the internal market is expected to fuel import demand. An empirical assessment of this demand effect should however take into account the fact that demand elasticities significantly differ by product and by supplier. In particular the elasticities estimated for all developing countries differ from those measured for individual countries and sub-regions as a result of differences in the economic policies adopted by these countries and/or the product mix. Artificial market segmentation, such as preferences, may cause a further increase in demand elasticity. There is reason to assume that the demand elasticities estimated for developing countries' products are higher than those for all extra-EC suppliers. This hypothesis is based on the observation that developing countries in general and some countries in particular (for example South Korea) succeeded in raising their share in apparent consumption of all OECD countries during the 1970s and 1980s (OECD, 1986). This holds true for those countries which achieved rising shares of non-traditional products in their export supply, such as the Asian newly industrialised and nearly industrialised countries.

As a yardstick for integration effects, EC and US import demand functions have been estimated for manufactures exported by developing countries (for details see Langhammer, 1990). The US estimate is to capture the effects of a large internal market comparable to the one now being formed by the EC. What matters for the assessment of growth effects on import demand are the income elasticities. The estimates show that they do not differ significantly between the EC and the US and that they are in the range of 5–5.5, with the higher value attributed to the EC. This would mean that – assuming 1 per cent added growth in the EC – real manufactured

imports would rise by 5.5 per cent annually, that is by \$2 billion in current prices or – in terms of world manufactured exports of developing countries in 1986 – by slightly more than 1 per cent.

However this growth effect does not take into account estimates of the static trade effects due to a once and for all change in relative prices between domestic supply and imports. The Emerson Report (1988, pp. 180–2) estimates that there will be a fall in relative prices as a result of the removal of internal trade barriers, and that this fall will lead to a trade diversion effect in the range of 10 per cent of the initial level (extra-EC imports in 1985). Related to EC manufactured imports from developing countries and compared with the growth-induced additional import demand, the once and for all reduction of imports from developing countries would amount to approximately \$2.3 billion, that is, slightly more than the value estimated above of additional import demand for *one* year. Therefore over a period of five years additional import demand is expected to exceed the trade diversion effect by more than fourfold.

Of course such estimates merely capture past reaction patterns to the extent that the internal market reacts or rather shifts over time because of other reasons, so their validity for the future must be viewed with caution. Although the comparison of income elasticities between the US – as an already completed single market – and the EC does not suggest major changes for developing countries, this does not exclude temporary shifts between domestic and foreign supply in the early stage of the EC single market. The question arises of whether there will be a constant or increasing import propensity or whether a declining import propensity will offset the growth-induced increased import demand. To answer these questions, scenarios of likely changes in the production structure of the EC after 1992 are required.

The following alternatives come to mind. First, the sector which receives the largest benefits from intra-EC liberalisation is the service sector. This sector would expand much more than predicted by long-term trends (3-sector hypothesis). The US, which has already liberalised its services' markets, may serve as a reference for the extent of expansion. Input-output analyses show that the import propensity of final demand for services is generally lower than the import propensity of final demand for commodities and manufactures. If this holds true, the import propensity of the EC could decline.

Second, there may be a countervailing effect in the sense that the

income elasticity of demand for some consumer services (tourism, passenger transport, non-commercial insurances, banking) is higher than for manufactures and tends to increase with rising income. Some of the more advanced developing countries which have already proven themselves competitive in supplying services to EC consumers in aviation, maritime shipping and travel could draw benefits from rising incomes and high demand elasticities. For these countries, import market penetration could accelerate.

Third, the completion of the internal market requires an enhanced integration of the two new EC members which have the strongest similarities in relative resource endowment with developing countries. Spain and Portugal will have to pass through the three stages of integration (free trade area, customs union, common market) much more rapidly than did the older members. Increasing investment flows into these new member countries reflect the progress of integration into the heart of the EC, but they also contribute to the establishment of new production capacities, replacing import of the old members from non-member countries (trade diversion). Furthermore the Spanish and Portuguese currencies may appreciate in real terms because of the capital inflows, thereby improving the competitive position of suppliers from developing countries on domestic and international market vis-à-vis Spain and Portugal. As new members of the European Monetary System (EMS), Spain and – probably soon – Portugal will not be able to autonomously realign their exchange rates. Claims for protection against developing countries are therefore likely to become more rigorous and this may mean that part of the adjustment burden faced by the new member countries will be shifted to developing countries. Here a ‘fortress Europe’ of some sorts could materialise and lead to declining import propensities, at least for some industries.

Fourth, the creation of the internal market may attract investment from non-member countries which otherwise would have been aimed at developing countries. Investment diversion may impede the transfer of technology to developing countries and this may affect the supply capacity of these countries. The exchange rate effect also has to be taken into consideration. As a result of massive capital inflows the ECU would appreciate in real terms and this would improve the competitive position of those developing countries pegging to non-ECU currencies.

Fifth, stronger competition, economies of scale and the harmonisation of standards by law (*ex ante*) or by competition (*ex post*) within

the EC will give rise to innovations which accelerate labour-saving technological progress. As a result the capacities of some industries may be relocated to the EC. Episodical evidence in the clothing industry, for instance, highlights this possibility (Mody and Wheeler, 1987; Jungnickel, 1989). In the short term, shifts in investment back to the EC could hamper developing countries' exports in those industries which are vulnerable to labour-saving techniques. On the other hand there must be other manufacturing sub-sectors which EC suppliers will have to leave because of rising wage levels and structural change.

Sixth, technological progress in the internal market will not only be labour-saving but also resource-saving and less polluting (Siebert, 1989). Demand for fossil fuels and for mineral commodities could be increasingly de-linked from economic growth. Commodity exporters among the developing countries could become seriously affected as the short-term demand effect for commodities would be overshadowed by the medium-term effect of economising on commodities. Countervailing effects are possible in the agricultural sector if the EC reduces its degree of market intervention in the agricultural sector under international pressure and budget constraints. However in principle the reform of the CAP should be dealt with separately from the internal market.

To summarise, there is no ready answer for changing import propensities after 1992. Effects will differ by countries affected as well as by product. All one can say is that a short-term decline in import propensity would remain a transitory problem if the transmission process between EC internal prices and international prices is allowed to run via flexible exchange rates as well as liberal trade policies.

19.3 REMNANTS OF NATIONAL SOVEREIGNTIES IN TRADE POLICIES: POSSIBLE CONSEQUENCES FOR DEVELOPING COUNTRIES

The completion of the internal market requires that remnants of national quantitative restrictions are fully abandoned. This condition has not yet been met, as has been shown in previous chapters. In 1988 about 1000 national quotas still existed outside the textile industry, but only 4 per cent of these were made effective by invoking Article 115 of the EEC Treaty in order to control intra-EC trade in such

products (Bundesverband, 1988, p. 7). This low share suggests that most national quotas are redundant and will be removed after 1992 (for example see Ab1, L 2429/89 of 28 July 1989). Yet a hard core of national quotas exists in textile, clothing, entertainment electronics and – the major stumbling block to a common trade policy – in the car industry. Chapter 18.3 provided a survey on measures under Article 115, mostly invoked by Ireland and France against Asian countries and newly industrialised countries. In the agricultural sector, national quotas are still relevant for some tropical products like bananas, while excise taxes in some member states on products such as coffee are looked upon as a further national barrier to imports (Chapter 16).

One test case of whether remnants of national sovereignty in trade policies will be abandoned after 1992 is the car industry and the common treatment of Japanese car exports to the EC. Consensus is hampered by the different character of national measures. These comprise strict per unit quotas (Italy, Spain and Portugal), the surveillance of ceilings in terms of upper limits in percentage shares of imports for newly registered cars (France), privately organised VERs between importers and exporters (UK) as well as progressive national sales taxes (Denmark and Greece). It is very likely that controversies among EC member countries on a common policy in the car industry will affect advanced developing countries in the future. This may occur either directly if low-cost suppliers like South Korea and Malaysia try to penetrate EC markets and then face local content requirements, or indirectly if suppliers of car components in developing countries suffer from barriers against Japanese investments outside Japan.

Furthermore developing countries' exports have mainly fallen into product categories which have hitherto been subject to national quotas in all national markets, but were quotas are controlled either liberally or restrictively. Cases in point are the sensitive categories of the MFA. Just how differently individual EC members have handled their quotas in the past has been nicely demonstrated by Hamilton (1986, cited in Winters, 1987) who estimated tariff equivalents of national quotas for Hong Kong exports of jeans to the EC. Estimates ranged from 32 per cent for the UK to 11 per cent for France and 0 per cent for West Germany, which did not enforce its quota.

Where such remnants of national sovereignty exist, there are three scenarios for possible changes to comply with the 1992 target. First, under a *pessimistic* scenario national competence in sensitive sectors (clothing, cars) cannot be abandoned until 1992. This scenario in-

cludes the replacement of national quotas by national escape clauses and safeguards which are likely to make things rather worse than better. Second, under a *neutral* scenario national quotas would be replaced by a common quota. Third, under an *optimistic* scenario national quotas would be abandoned without any substitute.

A realistic assumption for the neutral scenario would be the introduction of a common quota being the sum of national quotas. Assuming quotas would have been applied by all members in the same way, the import volume would not change after 1992. The political economic background of consensus-building suggests a gloomier result though. Restrictive partner countries are expected to agree to a common quota only under the binding commitment of all members to apply the quota strictly. Such commitment could mean that relatively liberal members would be disciplined under a common administration of quotas whereas in the past they were free to lift national quotas by 'revealed preference'. Under such a scenario, strict control of a common quota would reduce market access compared to the side-by-side implementation of less restrictive and more restrictive national procedures.

The extent to which national quotas are differently applied is evident in Tables 18.1 and 18.2 (Chapter 18). As quotas were politically negotiated on a case-by-case basis, low and strictly controlled quotas for countries like France and Ireland provided an incentive to exploit the potential of price arbitrage and to shift imports from open markets to restrictive markets. To discourage this the latter countries invoked Article 115 and thus prevented prices from falling in their markets. Under a common quota prices would be expected to fall in the restrictive markets and to rise in the relatively open markets. This would affect the export earnings of developing countries from individual EC member countries.

Apart from income effects which arise from changing export earnings, a common quota may become important for suppliers acting under oligopolistic competition. The segmentation of EC markets due to national quotas, and the scope for price discrimination, may have enabled foreign suppliers to exploit the consumer surplus more fully than they could have done under a common quota. In this respect a common quota could be instrumental in eroding economic rents in the formerly restrictive markets and intensifying the competition between established suppliers and new comers, but also in creating new rents in the formerly open markets.

A transitory common quota seems to be preferred by EC officials

Table 19.1 Static trade effects of removing national quotas against developing countries

<i>Exogenous parameter</i>		<i>Relevance of national quantitative restrictions^a</i>	<i>Estimated trade creation (TC)^b</i>		<i>Estimated trade diversion (TD)^c</i>		
			<i>in millions of ECU under MFN rate</i>	<i>GSP rate</i>	<i>in millions of ECU under MFN rate</i>	<i>GSP rate</i>	
Average MFN tariff for semi-manufactures and manufactures from developing countries (in per cent)	7.1	FRG	0.1	1.1	1.2	1.0	1.0
		France	10.8	65.1	69.1	43.2	45.9
		Italy	6.1	35.9	38.1	24.2	25.7
Average GSP rate (in per cent)	0.9	UK	12.3	104.1	110.5	89.9	95.5
		Benelux countries	0.6	4.0	4.2	3.3	3.5
Tariff equivalent of national quota (in per cent)	10.0	Denmark	5.2	3.6	3.8	6.9	7.4
		Ireland	2.2	0.6	0.7	0.6	0.6
Price elasticity of import demand	-0.96	EC-9	-	214.4 ^d	227.6 ^d	169.1 ^d	179.6 ^d

Notes: a. Imports from developing countries subject to national quantitative restrictions as percentage of total EC member country imports of semi-manufactures and manufactures (CCT 25-99) from developing countries (excluding fuels), 1978 in per cent.

- b. Estimated as follows: $TC = M_E \cdot \Delta t_Q / (1 + t_Q) (1 + t) \cdot e_m$

Where M_E = initial imports according to note (a) in 1987.

Δt_Q = reduction of tariff protection by the tariff equivalent of quota t_Q .

t = tariff rate without the average tariff equivalent.

e_m = price elasticity of import demand.

- c. Estimated by using the so-called non-restrictive Verdoorn concept: $TD = M_E \cdot [a(e_s - e_m)] \cdot \left[\frac{\Delta t_Q}{(1 + t_Q) (1 + t)} \right]$

Where a = share of extra-regional imports from non-developing countries (M_{NE}) in total imports of the EC from no members ($a = M_{NE} / (M_E + M_{NE})$) and e_s = elasticity of substitution between imports from developing countries and non-developing countries. This elasticity is assumed to be -2.0 . See for the various assumptions underlying the estimates of trade diversion Sawyer and Sprinkle (1989).

- d. The sum of trade creation and trade diversion amounts to 0.8 per cent (MFN rate) and 0.9 per cent (GSP rate) of EC-9 imports of semi-manufactures and manufactures from developing countries in 1987.

Sources: Langhammer, 1981, Table 1; Borrmann et al., 1985, Table 37; EUROSTAT, Foreign Trade NIMEXE 1987; own calculations.

for those products in which quota markets and non-quota markets still exist side by side (Krenzler, 1988). As far as MFA products are concerned, MFA IV (1986-92) already includes some adjustment measures, for example the lifting of non-utilised quotas or the partial transferability of quotas among member states (Neundörfer, 1987, pp. 49-54). Yet individual VERs between the EC and developing countries still include national quotas for sensitive products and these will remain in effect until the end of 1992, or rather until agreement is reached on what is to happen to Article 115. Therefore there is reason to assume that in such cases some EC members will insist on a transition period.

The optimistic scenario assumes that national quotas will be abandoned without any substitute. A possible compromise would be a transitory rise in the common external tariff by the tariff equivalent of a common quota. The possible static trade effects of this optimistic scenario are presented in Table 19.1. The magnitudes of trade creation and trade diversion depend mainly on the importance of national quotas in individual EC member countries, and thus imports are expected to increase in particular in France, the UK and Italy. Yet, as in all empirical studies on static trade effects, the magnitudes in terms of total trade are marginal because of both low tariff equivalents and low price elasticities of demand. This holds for trade creation (replacement of domestic production by imports) as well as for trade diversion (replacement of imports from OECD countries outside the EC by imports from developing countries), both of which are once and for all effects. Compared with the income-induced increase of import demand, the price-induced increase of imports due to the dismantling of national quotas is estimated to be much lower. Yet, compared to the neutral scenario, the optimistic one would offer a unilateral improvement of market access and a true step towards a single market.

19.4 DISCRIMINATION BETWEEN DEVELOPING COUNTRIES: WILL UNEQUAL TREATMENT BECOME REDUNDANT AFTER 1992?

The EC tradition of discrimination is deeply rooted as the EC itself is a preferential trading arrangement. There is no other actor in the international trading system who has deviated so widely from the principle of unconditional MFN as has the EC. Special treatment of

developing countries under the GSP and the special Lome' and Mediterranean Preferences, special treatment of Eastern European countries, political preferences for sectoral arrangements and safeguard protection on a selective basis within the GATT framework bear witness to this statement. With respect to developing countries, the EC has tried to use trade policies as a vehicle for resource transfer (by allowing developing countries to raise their export prices by the amount of tariff revenues foregone).

Criticism (Patterson, 1983; Wolf, 1987) as well as discouraging results (Chapters 16 and 17) have spurred reform within the preferential trading arrangements, but there has not been a move to separate trade policies from aid policies and return to MFN treatment. Whether this will take place after 1992 cannot be answered because the outcome of the other four major negotiating rounds concerning the international trading system are still pending. Nonetheless the following hypotheses can be advanced.

First, the EC will not abandon the principle of unequal treatment of different groups of developing countries, mainly in order to avoid an erosion of the preference margins of the ACP countries. Second, within the ACP framework the trend away from largely ineffective trade preferences toward the transfer of resources will continue. Should the trade performance of ACP countries on EC markets deteriorate further – *inter alia* as a result of the integration of Spain and Portugal into the EC – additional transfers are likely to be granted as a substitute.

Third, Mediterranean countries will receive special attention by the EC as their export structure shows a stronger overlap with that of the new member countries than that of ACP countries and the new entrants. Thus the full integration of Spain and Portugal is likely to have a short-term negative impact on the Mediterranean countries and will require compensation payments if their earlier status is to be maintained. Nonetheless, should the currencies of the applicant countries appreciate in real terms because of rising unit labour costs and massive capital inflows, Mediterranean countries could improve their relative competitive position vis-à-vis Spain and Portugal.

Fourth, advanced developing countries, and especially the small group of Asian newly industrialised countries, will be graduated after 1992. This means that preferential treatment of their exports will not be improved but 'frozen', perhaps even diminished as a kind of 'admission fee' levied by the EC for allowing access to a large single market (Krenzler, 1988). Fifth, tariff preferences, regardless of

whether they are general or region-specific, will become less relevant simply because of MFN tariff cuts in the GATT framework. However in those trade policy issues where decisions have to be negotiated the EC will continue to prefer bilateral over multilateral negotiations whenever possible.

What matters even more for developing countries is the question of when the EC will pay tribute to the ongoing globalisation of production and new assembly methods in manufacturing (just-in-time-procedures, module-type assembly). Both trends render traditional trade policy discrimination (and its implementation by rules of origin) largely ineffectual. Controversies between the EC, individual member states and private investors on minimum local content requirements (such as in the Nissan case of cars produced in the UK and exported to France) support concerns about future disputes challenging the EC and the European Court. The same holds true for the recent decision of the EC to link free intra-EC trade in chips to the location of a specific production stage within the EC (diffusion process).

The legal framework for traditional EC trade policies fails to provide guidelines for settling such disputes between investors operating world-wide and the EC authorities trying to enforce the fiction of an EC-originating product or – with respect to investment – of an EC-based company. Three factors however provide reason for hope that the EC will refrain from intervening excessively in flows of investment in order to keep specific investors out of the single market. First, there exist a large number of legal and illegal options to circumvent control on local content and rules of origin. Second, the possibility of retaliatory action by Asia-Pacific and the US is strong. And third, challenge and response games between investors and the EC are limited by EC budget constraints.

19.5 EXTERNAL EFFECTS OF LIBERALISING INTRA-EC TRADE IN SERVICES

As mentioned above, the liberalisation of services is one of the key tasks of the 1992 operation. It is strongly linked to the liberalisation of intra-EC capital transactions as there will be no free trade in financial services without free movement of capital.

As trade in invisibles frequently escapes statistical registration (Langhammer, 1989a, 1989b), there is only very skimpy information on the competitive strength of developing countries as suppliers of

services. Tourism, passenger transport (aviation), as well as merchandise transport emerge as those broad categories of services in which a large number of developing countries have improved their international competitiveness. Construction activities, engineering and financial services are relevant for only a few advanced developing countries.

Irrespective of the speculative nature of this issue, a number of hypotheses can be advanced. Concerning tourism, relative prices of tourist services inside and outside the EC are expected to be influenced by two countervailing aspects of the EC single market. Internal prices will fall because of intensified competition in the aviation market and international mergers of travel agencies. On the other hand, internal prices may rise once and for all if a VAT of 6.5 per cent is levied on intra-European travel as well as if a fuel tax is imposed on intra-EC shipping. Finally, airport companies may try to raise their fares in order to compensate for the loss in earnings from duty-free shops, which will become redundant in the single market.

The net effect of both price movements is uncertain as changes in the real exchange rates of the European tourist resort areas have to be taken into account. With rising unit labour costs in the Mediterranean member countries there is room for the assumption that the ratio between internal and extra-EC prices for tourist services will increase, thus providing a chance for developing countries to attract tourists.

The aviation market is of considerable export interest to low-cost carriers in developing countries. This market is characterised by an extremely high degree of bilateralism, and though the Commission has subjected aviation to the competition rules of the Rome Treaty, there will be no common policy until 1992. Capacities have been expanded because of lowered barriers to entry, but price competition is still very restricted because of the so-called group exemption in the competition articles through which pool arrangements are sanctioned. As long as other member countries still have the right to protect their national flag carriers (for example France and Germany), price competition will be confined to a few routes within the EC. The recent nationalisation of private carriers in France does not support the optimistic view of enhanced competition between newcomers and national flag carriers in the context of 1992.

Developing countries are interested in the EC aviation market mainly with regard to the concentration issue. Should intensified competition among EC carriers lead to a concentration process with

few remaining mega-carriers, negotiations on landing rights and slots are likely to become more difficult than under current circumstances because of changes in relative bargaining power (Mathew, 1989). 'Fifth freedom rights' are expected to be guaranteed for the period beyond 1992 so that the definition of intra-EC transport as 'domestic' transport would not mean denying third countries the right to supply transport services as they did in the past.

Unlike the aviation market, the Commission has gained a mandate in maritime transport to act against third country suppliers if they are accused of unfair pricing. In a case decided in early 1989 the Commission imposed for the first time a countervailing duty on an external supplier of services, a South Korean shipping company operating a liner service between EC ports and Australia (Ab1, 15/89, L 4, 4 January 1989). This company allegedly received subsidies and thus was able to undercut European companies, who requested that the 'unfair pricing' regulation be imposed by the Commission. This regulation can be regarded as the nucleus of a common policy in maritime transport against third countries. A common policy is facilitated by the fact that most EC shipping agencies already act jointly in liner conferences and have established common institutions to lobby in Brussels.

In banking and insurance, third countries are confronted with the reciprocity clause in the so-called Second Banking Draft Directive. Banking licences, which are necessary when providing services in the single market, are issued if EC banks and insurance companies do not report discriminatory actions against their own business in the third country. The debate on the reciprocity clause became heated because of the vague definitions set in the first draft, but passions seem to have subsided with a new draft, through which licences are issued bona fide rather than after an examination of the conditions in the applicant country. For the majority of developing countries, the reciprocity clause will be ineffectual since their banks have only established funding offices or financing agencies for merchandise trade in EC countries rather than branches offering the full range of banking services.