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EC 1992: Strategic and policy issues for the 1990s:with special reference to developing countries and Yugoslavia

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EC 1992: Strategic and Policy Issues
for the 1990s
- With Special Reference to
Developing Countries and Yugoslavia -

by
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August 1989

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<u>Contents:</u>	<u>Page:</u>
I. Introduction: Defining the Agenda	1
II. The Single European Act	4
III. What to Expect from the EC '92	11
1. EC Countries' Interest in the EC	11
2. Accomplishments Towards EC '92	14
3. EC '92 and Third Countries Interests	15
4. The Production Potential of Third Countries	19
IV. The Trade Diversion and the Trade Exclusion Issue	22
V. Policy Issues	26
1. The Cecchini Report	27
2. Alternatives	30
VI. Concluding Remark	34
References	36
Table 1: MFA Quotas of EC Countries	16
Table 2: Trade-Share Effects of EC Integration and EC Enlargement Regarding Industrial Products - Ballpark Estimates	25
Table 3: OECD Exports by Region and Product Structure, 1965 and 1985	38
Table 4: OECD Imports by Region and Product Structure, 1965 and 1985	38
Table 5: Regional Shares of OECD Imports by Product Group, 1965 and 1985	39
Table 6: International Competitiveness of Regions vis-à-vis OECD Countries by Product Group, 1965 and 1985	39
Table 7: Regional Trade Patterns of EC-12: 1958-1987	40
Table 8: Regional Trade Patterns of EC-6: 1958-1987	41

I. Introduction: Defining the Agenda*

1. When we refer to the EC 1992 these days we think about the introduction of the "single-internal market", i.e. a market with no discrimination on the grounds of the nationality of buyers and sellers as far as the member countries of the EC are concerned. This tends to lead us into deep waters when it might be prudent to stay in shallower ones, by saying that the internal market is a market with no internal frontiers, and thus with free traffic of goods, people, services, moneys, capital, investments, ideas etc. Depth, on the other hand, cannot be avoided when contemplating on the non-discrimination issue, e.g. on what would become of the other kinds of discrimination, which are not due to the nationality of buyers or sellers. A perfectly discriminating monopolist, for instance, would be allowed to trade his goods and services under the conditions of a single-internal market just like before under the conditions of the "non-single" internal market; if it happens that elasticities of demand differ among member countries this monopolist would - by discriminating purely on the grounds of economic reasoning - discriminate on grounds of nationality when taken by its face value.

Depth continues when the free traffic of bads is considered, which would include bad people, bad services, bad moneys, or bad ideas, - are bads an exemption to the "single-internal market" (SIM) rule? And if so, why? Tradability of bads in only one or a few of the EC countries would quite obviously constitute a contradiction to SIM.

2. The implication of defining SIM according to the "non-discrimination on national grounds" rule would necessarily imply that the much-discussed issue of harmonisation is of lesser importance

* Paper presented at the workshop "EC-Yugoslavia-System and Policies Compatibility" of the Institute for Economic Research in Ljubljana. I wish to thank Lojze Sočan and the other participants of the workshop, as well as my colleagues Ernst-Jürgen Horn and Fiona Short for helpful comments.

in comparison to the issue of (internal) liberalisation. Or, to put it differently, SIM as defined above would induce every country to accept within its boundaries whatever is produced and supplied in one of the other member countries. The country-of-origin principle would in this case have won victory over the country-of-destination principle, would it not?

3. The act of conducting a war is originally meant when strategy comes into play; the adjective is also used as a friendly cover-up, such as in "strategic retreat". For the ancient Greeks the strategist was the highest government official in a province, but also the advisor in military problems (who often became a political leader, e.g. Pericles). Today, strategy has become synonymous for a plan. Since behind every plan there is a goal to be achieved the goal is a logical precursor to the strategy. When firstly stating the goal there are in most cases more than just one or two possibilities of achieving it. Acting according to a plan under the condition of existing (real or theoretical) alternatives of action as well as of alternatives of goals would define the scope of politics.

4. Strategic issues are manifold, depending on who the strategist is:

- If it is the EC's administration, the main problem to be solved strategically is the one referring to the decision of how much harmonisation of rules, regulations and institutions is compatible with the basic SIM idea of liberalisation. The outcome of this decision will impinge, to a large extent at least, upon the strategic behaviour of other agents, like LDCs, Comecon countries, Japan, the US and, of course, Yugoslavia.
- If it is the Federal Republic of Germany's government, it might be interested in postponing the liberalisation of the service sector (see below); instead of saying so explicitly, the FRG would, more indirectly, strive for the harmonisation of the rules governing the service sector in order to protect allegedly consumer interests.

- If it is Yugoslavia, she should want to minimise the eventual negative effects from "trade diversion" - like any other third country - and try to profit as much as possible from the increased division of labour which is due to the trade-creating and growth-enhancing effects of EC '92.

On the other hand, the strategist may be concerned with functionally instead of nationally-defined groups, such as producers, or consumers; he may also have sectoral interests, e.g. coal mining, steel production or high-technology productions. Last, but by no means least, are those strategies which are directed towards entities which can be distinguished by criteria of national accounts; these can be found in the exporting sector or the importing sector. In each of these cases, the contents of a strategy as well as the final outcomes differ. Producers are interested in high prices, i.e. in tariff and non-tariff protection (possibly in the form of consumer protection), and in cartels. Consumers on the other hand may prefer protection by lower tariffs and by no consumer protection. Coal and steel producers are in need of subsidies which the rest of the economy has to pay; governments at the same time reveal preferences for subsidising high-tech producers, which are at the opposite end of the factor-intensity scale.

5. Where does all this take us? For a working hypothesis I should suggest that the issue at stake is to improve the interrelationships between the EC and Yugoslavia until and after 1992 in such a way that both regions derive profits from this amelioration. The strategic problem at hand would be what to do in view of the fact that mainstream economic reasoning tells us that third countries will be worse off in all cases of regional integration.

6. Below I shall firstly analyse the main issues and changes in the laws of the EC as presented in the Single European Act, with special reference to less developed countries, to Comecon countries, and to Yugoslavia. Since there is hardly a thought lost on these countries in the Act explicitly, an attempt will be made to

bear in mind the basics of economic integration theory, namely that regional integration leads to trade creation and growth of real incomes within the region, and that it induces trade diversion and a decline in the real incomes of third countries. In the third chapter I shall deal with the strategies of individual EC countries because these strategies can be considered to impinge upon the real development of EC-internal integration in the future. The resulting picture of the EC 1992 will lead, fourthly, to the problem of strategic responses of third countries, especially Yugoslavia.

II. The Single European Act

7. The Single European Act (SEA) changes the economic environment of EC and Non-EC countries in several major aspects; an analysis of the SEA text shows that almost all of these aspects are soaked with the desire to have a high(er) degree of policy co-operation. This interest in co-operation is explicitly introduced in Title III (out of IV titles) with respect to the sphere of foreign policy, and for EC countries it endeavours to produce - taking its own words - "combined influence" (Provision 2a), "cohesive force" (2d), "consistency" (5), and "European identity" (6a).

Institutional change embedded in the provisions of the European Economic Community¹ (EEC) also exhibits the distinct marks of the co-operation theme. In particular, it is the introduction of co-operation between the Council and the European Parliament into the Rome Treaty in Articles 7, 49, 52, 56, 57, and all over the new, lengthy version of Article 149 as well as Articles 145, 237

¹ The change in the provisions of the European Coal and Steel Community (ECSC) and of the European Atomic Energy Community (EAEC) pertain to the establishment of an additional first-instance Court of Justice only, and the procedures to be adopted regarding the composition of this court. This additional court is also suggested in the EEC part of the SEA.

and 238. This cooperation upvaluates a body which has only few identification marks of that kind of democratic body which we are used to calling parliament.²

8. Co-operation is the political phrase for a phenomenon which economists term cartel; since cartels are regarded - by economists - as a welfare-reducing malfunction of an economic system legal checks and balances have generally been introduced which are to provide for competition not restrained by collusions among buyers or sellers. Therefore, an economist's first impulse would be to look at the checks and balances regarding the co-operation between Council, European Parliament, and Commission (and, probably, the Court of Justice). He would not find too much there. The separation of powers, constituent for western democracies, is hardly developed - if one were not to take the implicit control of each nation by all others for a substitute. In fact, the Council consists of (specialised) ministers of national governments, not even effectively controlled by their colleagues in the respective national cabinet. The members of the Commission are also delegated by the national administrations, as are the members of the Court of Justice. And the controlling power of the "Parliament", finally, is very limited because it is a co-operating body, which in addition can be overvoted by the Council (Art. 149, II, c).³

The hypothesis derived from the institutional setting of the EC and its changes is that the way strategic decisions will be made over in the next few years will not least of all depend on this setting.

² In the beginning of 1957, the EEC treaty stipulated an "Assembly" which had to advise and to supervise. This Assembly was to meet regularly every year, on the third Tuesday of October (changed into the second Tuesday of March). The Assembly had little resemblance to a parliament, because it had - and still has - no legislative power. In addition, in the first decades the deputies were not to be elected by the people.

³ Only in cases of EC membership extension and of associating countries does the Parliament have the right to veto (Art. 237, 238).

9. Skimming briefly through SEA's "provisions relating to the foundations and the policy of the Community" makes the following highlights appear seemingly pertinent in terms of strategic issues:

- a. The period over which the internal market will have to be established has been extended from January 1, 1970 (Art. 8, I,1) - it was termed the "common market" - to January 1, 1993. This is important because it gives a sense of relativity to the SEA; it cannot be excluded that somewhere in the late 1990s we shall witness a third attempt towards the unification of Europe. Relativity is corroborated by the "Declaration on Article 8A of the EEC Treaty", where the EC's governments' representatives expressed their "...firm political will to take before 1 January 1993 the decisions necessary to complete the internal market...", and: "Setting the date of 31 December 1992 does not create an automatic legal effect".
- b. The principle of unanimity within the Council is in several instances replaced by the principle of a qualified majority, regarding e.g. alterations in the common customs tariff (Art. 28), regarding trade in services for nationals of third countries who are established within the EC (Art. 59), regarding regulations of air- and sea-traffic (Art. 84,II), etc. This change in the process of decision finding implies that few of the twelve member countries can effectively decide upon the suggestions of the Commission. It is interesting to note that, with respect to the co-operation in the sphere of foreign-exchange policy, unanimity has been replaced by the qualified-majority principle, with co-ordination defined as having the purpose of liberalising capital movements, whereas unanimity is now required for every step back in the degree of liberalisation of capital movements (Art. 70, I). This indeed seems to constitute a major indication of the intent of SEA to liberalise.
- c. Of the harmonisation issues of articles 99, and 100 B, indirect taxes have already received wide attention. Some believe that tax harmonisation is an essential prerequisite of integration (in order to achieve equal competitive conditions),

others say that the taxation schemes are a factor determining the (international) allocation of resources and the exchange rates like any other "natural" factor.⁴ According to the latter view - which may be called "economic" as opposed to the former "constructivist" (Giersch, 1988) view, harmonisation would distort the structure of incentives and along with it the allocation of resources. Bad policies (which lower the marginal productivity of capital and labour) should have the same chance as good policies (which increase productivities) to be reflected in a higher or lower tax burden; only then would politicians sufficiently feel the incentive to mind their citizens' welfare.

Perhaps of even greater importance is the SEA provision that the Commission has to take "as a base a high level of protection" as far as health, safety, environmental protection and consumer protection are concerned (Art. 100 A, III). This of course does not refer to straightforward protection, like tariffs or subsidies. But very often, the denial of the right of consumers to buy from the cheapest source possible is the underlying rationale of many a protectionist device: in order e.g. to prevent predatory pricing West German authorities intervene in the pricing of the fertiliser and pharmaceutical industries; competition is strictly regulated as far as the supply of insurances is concerned; the famous beer case has just been the top of the iceberg of West German consumer protection.

Mention must also be made of the quite interesting provision that an inventory of national laws and regulations will be drawn up in 1992, together with "appropriate proposals in good time to allow the Council to act before the end of 1992"

⁴ With respect to national differences in the levels of taxation it can indeed be argued that high tax revenues may help to finance a high output of public goods - which finally increases the productivity of the private sector. National differences in the revenue structure of taxes can, in the same line of argumentation, just reflect national differences in the optimal way of raising revenues.

(Art. 100 B, III) - an inventory which quite obviously will consist of proposals for harmonisation.

- d. Co-operation is the main theme of the "Monetary Union", too (Art. 102 A). The Single European Act does not nearly devote as much space to this union - which would require a new treaty - as it does to the preceding parts concerning the institutional changes and the internal market. It is said that the experience acquired with EMS and ECU will be taken into account, and that - among others - the governors of the central banks will be consulted. At a first glance, the noise made by the central bankers, by politicians and by the newspapers about the monetary union seems to be much ado about relatively little co-operation.
- e. The Social Charter - sometimes labelled the "Socialist Charter" - sets the objective of the harmonisation of the conditions of the "working environment" (Art. 118 A), and articulates the aim of "reducing disparities between the various regions" (Art. 130 A). It is important to know that the reduction of regional disparities - of per capita incomes, I presume - is binding for the implementation of all measures discussed above (which were to create the internal market). Indeed, most of the additional financial means of the EC seem to go into the "European Regional Development Fund (Dicke et al., 1987). Also among the means with which to achieve parity there is the well-known "European Agricultural Guidance and Guarantee Fund", a fund which has played the rôle of buying agricultural overproduction and of trying to get rid of it.
- f. A major effort of re-allocating resources will be made regarding "research and technological development" activities, in order to "strengthen the scientific and technological basis of European industry" (Art. 130 F to Q). It is in this context that third countries are mentioned: co-operation with third countries (and with international organisations) will be pro-

moted. The key words of the R&D chapter are

- Optimisation of Community R&TD results,
- Stimulation of researchers,
- Demonstration programmes,
- Co-ordination among member states and promotion of such co-operation by the Commission,
- Multi-annual framework programme,
- Specific programmes, each defining detailed rules for implementation,
- Supplementary programmes (for certain member countries only),
- Participation (of the Community in national R&TD programmes),

Of all these so important aspects one is of even greater importance: the framework programme will supposedly "lay down the scientific and technical objectives" and define priorities.

g. The control of environmental damages is, one should assume, not of an outstanding importance for third countries. Nonetheless it is here again where third countries come into the legislative play: the Community and the member states are to co-operate with third countries and with international organisations (Art. 130 R, V).

10. Broadly speaking, some of the above issues are rather apt to serve as a nightmare for those who expected the EC '92 to become a leader in the world-wide race for free markets. These issues are the provisions about R&TD policies, about consumer protection, about the harmonisation of working conditions and about the convergence of regional disparities deemed necessary. With respect to R&TD policies there are great amounts of money already spent on fostering R&D on international levels, including EC countries. One might mention here the subsidisation of transfers of technologies into the third world by the World Bank, or the

existing co-operation within EMBL (European Laboratory for Molecular Biology; founded (*) in 1973), ESA (European Space Agency; *1964), ILL (Institute Max von Laue - Paul Laugevin; *1967), CERN (European Organisation for Nuclear Research; *1954), ESA (European Space Agency; *1975), COST (European Co-Operation in the Field of Science and Techniques; *late 1960s), not to speak of ESPRIT, or EUREKA, etc.

On the other hand there is the internal market issue; it is greatly supported by recent verdicts of the European Court of Justice [cf. the cases of beer, spaghetti and Crème de Cassis; see also Siebert (1989) and Grimm et al. (1989)]. They definitely encourage free marketeers because the decisions are in favour of a large European market with no frontiers on grounds of nationality of buyers or sellers. It is this aspect which plays the predominant rôle in the projections of the 1990s based on research financed by the EC (cf. chapter V). But why then not have a Single European Act with, say, only three single provisions - provision one being concerned with defining the internal market; provision two stating that this market will have to be realised by Dec. 31, 1992; and provision three giving each individual member country the right to open its frontiers independent of whether the other EC countries follow suit? It is the amount of complications in SEA which is worrying.

11. All in all, some of the changes in SEA can be expected to bear the distinct mark of liberalisation, such as in the case of capital movements, and some seem to show in the opposite direction, such as those which are concerned with strategic R&D policies. Most of the provisions, however, seem to be of a highly ambivalent nature. If, for example, the change towards majority voting is apt to resemble, in its final outcome, a major step towards liberalisation, or if the importance attached to a high degree of consumer protection is indeed meant to protect the consumers' interests in free trade instead of producers' (or bureaucracies') interest in the regulation of trade, then we have an obvious inconsistency over time: how can an institution which

has given birth to the Common Agricultural Policy, or to the European steel markets albeit when they are as heavily discriminated as they are today, and which has had a yearly output of regulations which even experts have been unable to cope with, how can the EC be expected to change the pace and direction of its policy abruptly? Is this the modern variant of a phoenix rising out of the ashes of a mislead integration policy? Or is the Single European Act rather a chimera, breathing fire and defending the fortress called Europe?

III. What to Expect from the EC '92

12. Below I should like to structure some ideas on what will happen to LDCs and to countries like Yugoslavia according to the main determinants of future EC actions as I see them. Firstly, it will be asked what the main member-countries' interest in the EC has been and will possibly be. Secondly, a short overview of what the Community has so far accomplished in preparation for 1992 will be given. Thirdly, a closer look will be cast on the specific product areas where the production interest of third countries seems to be similar to the production interests of EC countries, which by no means would imply common interests of EC and third countries. Fourthly, the capabilities of third countries as competitors of EC countries will be analysed, because wherever third countries may become, or will remain, competitive, there is bound to be trouble in the Single European Market.

1. EC Countries' Interest in the EC.

13. The establishment of the EEC, just like the ECSC, had for a starting point common interests in political co-operation, in a common representation of these interests towards third countries, and in the reduction of artificial barriers to economic exchange among member countries. During the 30 years thereafter many an integrational effort has been withdrawn, or at least been questioned:

- The ECSC has long since given up its brazen principle that subsidies ("in any form whatsoever", Art. 4c ECSC) are strictly interdicted; European steel suppliers are more concerned with the goodwill of the public administrations than with the goodwill of steel consumers today.
- The EEC has abolished its internal tariffs since 1968; only a complete outsider, however, would believe that consequently there should be no internal customs controls anymore. Quite the opposite is true. It seems that EEC countries have one really common interest: customs controls, and that each member state is sure that the other is incompetent regarding matters of internal security or economic rationality.
- When measured by the financial and administrative problems the most important part of the EEC is the one concerned with agricultural problems; is the Common Agricultural Market (CAM) in fact what the EC means when striving for an "internal market"?

Common interests do seem to exist in the sphere of high technology production, such as ESPRIT, which give testimony of the EEC's endeavour to play an important rôle in all techniques and productions which are believed to be relevant for the future. They also testify, of course, that not much weight is attached to Hayek's idea about the development of inventions and innovations being efficient only if the process of trial and error is decentral and competitive. It is interesting to note that the EC's bets are not placed on future productions where supply will be low, demand strong, and therefore profits as well as employment high, but rather on productions where other countries - such as the US or Japan - are also heavily engaged, where competition can be expected to be tough and profit margins low. In any case, the high-technology sector is the one besides that of agriculture where common interests seem to prevail, common interests of administrations, that is, not of tax payers or consumers.

Finally, diverging interests are manifest in so far as member countries maintain that historical peculiarities must be reflected in particular foreign relationships. This holds true for

the relations between the UK and her former colonies (not necessarily referring to the US or to Australia), and for the relations between West and East Germany. These specialities tend to confuse the EC's internal trade because they eventually lead to border controls within the EC in order to circumvent circumventions of trade (Art. 115).

14. If common interests are hardly visible - with the exception of protection of steel, agricultural, textile and high-tech productions - what, then, is in the interest of the individual major EC countries?

France, relying on planning for many years after World War II, considers herself to have fallen behind in matters of industrialisation. Her trade policies therefore reveal preferences in the industrial sector: protection of French production of video recorders (the famous Poitiers incident), or of automobiles exemplify this industrial interest. West Germany tends to dwell on the liberal image; nonetheless, she has exhibited interests in maintaining a high level of agricultural protection; and in the service sector the other member countries will witness a strong German urge for regulation (under the euphemism of "harmonisation") in the fields of traffic, energy supply, insurances, postal services, or medical supply. The Netherlands have suffered heavily under the auspices of the energy price hikes. In fact, the name "Dutch disease" refers to the problems which appeared in the wake of gas field discoveries: the decline in the terms of trade of the productive, non-energy-producing sectors, and the increasing share of the "unproductive" service sector. The term "disease" tells us that people are seldom happy when they have been lucky. The UK has also energy interests, as well as interests in industrial productions. The 1960s and the 1970s have shown enormous financial efforts to improve the production structure. Over the past few years the British Prime Minister has not seemed to have been too enthusiastic about the idea of European harmonisation, nor about the institutional delegation of parts of the national sovereignty. Instead, she seemed to rely more than other countries on the principles of competition on

product, service and political markets. Italy, seen from the outside, has also interests in oil production, but not mineral oil. She might share the interests of other mediteranean countries in protection of certain agricultural products. Industrial or agricultural protection is turned against third countries (such as Japan) and sometimes EC countries (such as France) as well.

15. All in all, these highlights reveal that there is hardly a field of production not covered by special interests of at least one EC member country. This would say that the simple implementation of a common or internal market is fiction rather than a probable prospect. Instead, if the Single European Act, or the EC treaty at large, renders a possibility of protection against competition somewhere, some country is bound to take it up. Harmonisation will be the EC's future in that case, not liberalisation.

2. Accomplishments towards EC '92

16. An analysis of the Commissions's proposals, made according to the time-table of the White Paper of the Commission, agreed to by the Council up to December 31, 1988 has recently been presented by Dicke (1989). Dicke makes reference to a proposal of the Commission which stated that in all those cases where an importing member country of destination finds out that its institutional regulations distort competition in such a way as to discriminate its own people vis-à-vis the exporting member country of origin, it may allow its firms to produce under the same conditions as the firms of the country of origin. Such conditions prevailing, consumers would finally decide upon the national regulations; these regulations should in the end become international because competitive pressures would force governments to adopt the most efficient rules and regulations. The idea of citizens themselves effectively deciding through their selling, buying and investing activities upon the levels and structure of taxes, standards, monetary policies, etc. should of course disconcert many a government official, parliamentarist, Councilor or Commissioner.

17. Dicke finds that of the 127 proposals of the Commission enacted by the Council up to the end of 1988, 86 (i.e. 67.7 %) are concerned with harmonisation. A mere 21 (i.e. 16.5 %) can be considered to have liberalised the relationships among EC countries. Some 16 (or 12.6 %) improved the standard of information (like declarations of content in drugs or foodstuffs). In other words: when applying Dicke's system of reference - providing for transparency in cases of quality differentials and then relying on the competitive forces as a means of co-ordination - two thirds of the Council's measures have not improved integration. To put it differently: the Single European Market too often is defined as being product-wise, i.e. biased towards the supply side, rather than towards the demand side, i.e. in terms of the rights of citizens to buy what they want, where they want.

3. EC '92 and Third Countries' Interests.

18. The Single European Act says little about third countries (cf. para. 9, f and g), and if it does so at all it is in terms of co-operation instead of non-discrimination. The widespread fear of a "fortress Europe" must either refer to the trade diverting effects of every regional integration, or the whole affair is much ado about some unknown "hidden agenda" of a new wave of protectionism (Cable, 1989). The latter is a problem of macro-psychology, probably a side-effect of the enthusiasm surrounding EC '92, and interpreted this way is another form of "trade diversion" - i.e. internal enthusiasm meeting corresponding external scepticism. Both kinds of diversions will not be considered now; instead, some items of major interest to developing countries will be looked at. I shall leave out exotic aspects such as what will happen to the Banana Protocol of the Lomé Convention.

19. The market which by tradition is the most sensitive in EC countries - besides the steel, shipbuilding and agricultural markets, of course - is the one covered by the Multi-Fibre Agreement (MFA). In the 1980s, for example, between 60 % and 75 % of all

Article 115 actions⁵ have been directed against MFA products (up to 7 % against agricultural imports, and between 22 % and 33 % against "other industrial goods"; Spinanger, 1989, b). The countries initiating action against imports of MFA products have been France and Ireland in about 80 % of the actions (in the case of "other industrial goods" France and Italy are the leading initiating countries), the number of product items goes into the hundreds (see Table 1).

Table 1: MFA Quotas of EC Countries (numbers of items covered)

	MFA1		MFA2		MFA3		MFA4	
	EC	National	EC	National	EC	National	EC	National
LDC total	128	102	376	101	361	153	?	?
Yugoslavia	18	5	19	-	13	3	?	?

Source: Cf. Cable (1989)

20. The big question is whether the EC '92 will really bring the internal market into being and thereby remove Article 115 which has the purpose of restricting circulation of goods among EC countries. The Single European Act says nothing at all about Article 115, and nothing about the abolition of safeguard clauses (which would be a clear-cut integration measure). Today, EC quotas on the MFA basis are in fact distributed and managed nationally, and they differ among member countries as regards the amounts imported, MFA products and LDCs affected, and the degrees of quota utilisation. The manufacturers' association, COMITEXTIL, is already voicing concern about the weakening of the national control system to be expected by 1992; COMITEXTIL is striving for levels of import quotas lower than the sum of the existing national quotas (Cable, 1989).

21. The best guess as to what will happen by 1992 should be one based on past experience. Experience tells us that in all cases of "sensitive" products, where "severe damages" for domestic in-

⁵ Article 115 allows an EC country to restrict indirect imports from non-member countries coming through other EC countries. Any Article 115 restriction must be approved by the Commission.

dustries are to be expected if imports are allowed to enter freely, transition periods are granted in order to give the domestic competitors time to adjust. This once led to the famous STA (Short Term Arrangement Regarding International Trade in Cotton Textiles) of 1961, the successor of which is MFA4, which will expire in 1991 unless the Uruguay Round decides otherwise.

Assuming therefore that there will be a period of transition established by the end of 1992, what will become of Article 115 and what about the level of the EC quota? A solid guess would be that national quotas will be added up to arrive at the new EC '92 level of import quotas, and that no country will be allowed to apply Article 115. In that case less developed countries will truly benefit from the Single European Market, because the intra-EC tradability of quota items will most probably lead to full utilisation of quotas, and it will dampen the regulatory costs of exporting countries. This would be a true phenomenon of trade creation in third countries due to regional integration of EC countries (where, consequently, trade diversion would have to be expected).

22. There is a variety of nationally-applied import controls the effectiveness of which also depends on the application of Article 115 in order to prevent circumvention of the national import controls. Passenger cars are probably the most interesting case in point. About one quarter of Article 115 cases in the non-MFA area are aimed at motor vehicles, which are at the same time 7 % of manufactured imports from third countries (Spinanger, 1989). The automobile industry is an industry where the Pacific Rim (PACRIM) countries have been successful (Japan), are on the brink of being successful (South Korea), or can be expected to be successful in the near future.

National quantitative controls of car imports are applied by Italy, who restricts imports of Japanese automobiles to a total number of roughly 3000 units, and by France who restricts imports to 3 % of total new registrations (not to mention the implications

of "national-content" provisions in EC anti-dumping law). West Germany has a loose VER with Japan, initiated by her liberal minister of economics in 1981, allowing imports to increase by 1 % of apparent domestic consumption per year (Spinanger, 1989). The loss to consumers can be estimated when looking at the unit values of car imports.⁶ The loss to the Japanese suppliers is harder to arrive at; and the loss to potential suppliers from the PACRIM region, from other NICs, or from countries like Yugoslavia must be sought in the dynamics of resource allocation in so far as trade regimes impinge upon investors' decisions.

23. Whether there is anything bound to change in the automobile section of the Single European Market is again not clear. Italy's waiver regarding imports of Japanese cars allows her to apply Article 115 in order to maintain a Single Italian Market in that respect. France has no such waiver and thus no right to apply Article 115 in this case - nonetheless she has been quite capable of factually restricting Japanese car imports from other EC member countries. Whether the Court of Justice will have a chance, and will take it, to issue another Crème-de-Cassis verdict for automobiles by 1992 remains open.

24. Most of the other quota regulations and VERs are, according to Cable (1989), bound to be "unenforcable" after 1992, such as UK restrictions on televisions and music centres, VERs on cutlery imports (in Benelux, Denmark, Germany and the UK), or consumer electronics (UK). On the other hand he recognises substantial pressures "to translate national footwear quotas and VERs to a 'mini-MFA' structure", including a surveillance system, at the Community level.

⁶ Spinanger's estimates show that the unit values of Japanese cars are on average
- 33 % above the German level in Italy and
- 9 % above the German level in France.
Germany herself had unit values (regarding automobiles with not more than 3000 cm³) of roughly 15 % above the Danish level (Denmark applying no import controls).

4. The Production Potential of Third Countries

25. The other prime determinant of third-country effects of the EC '92 besides the institutional change is the development of productivity and of the product mix in the structure of supply of third countries. The really small effects of EC '92 on internal prices, as analysed by Cecchini (1988) or by Smith and Venables (1988) could be easily compensated by increases in third countries' productivity or by a more attractive product mix of exports. For the purpose of analysis it will be assumed that countries performing well in the past can be considered to possess a high potential to compensate an internal price decline in EC countries (and vice versa).

26. In order to capture the "compensation potential" - which should be high for countries producing along their (changing) comparative advantage - a breakdown of trade flows according to the structure of inputs needed to produce them has been made.⁷

27. Table 3 may serve as a system of reference. It shows that the

⁷ Raw-material-intensive goods capture the comparative advantage of countries which are rich regarding the availability of natural resources; these goods often have income elasticities well below unity and countries relying mainly on such exports tend not to be among the dynamic ones.

Labour-intensive and capital-intensive goods refer accordingly to the relative availability of labour and capital in a country. The first gives LDCs a competitive edge, whereas the second is, in regional aspects, more indeterminate, since financial capital allocates where profits are highest and thus real capital accumulation is a function of past relative profitibilities. Income elasticities on average tend to be higher than in the case of raw-material-intensive goods, though often below unity.

EIRI and NEIRI goods both refer a relatively high share of human capital in the production process; the production advantages are mostly with the highly developed western countries, and the income elasticities of demand are above unity. Those human-capital-intensive goods whose production process is closely tied to R&D activities of the firm are labelled NEIRI goods (research-intensive goods which are not easily imitated); those human-capital-intensive goods whose production process is dependant on knowledge which is relatively easy to transfer across countries are labelled EIRI goods [(cf. Kostrzewa (1988))].

demand for OECD exports concentrates on NEIRI goods, and increasingly so, in all countries considered; increasing shares are also predominant in the EIRI-goods case. It simultaneously shows, of course, that comparative advantages of OECD countries lie more in research-intensive productions.

The conclusion that competition should therefore be particularly fierce on the OECD market regarding research-intensive goods would lead to a surprise: Asian NICs, as well as the total of LDCs improved their export performance in these fields by enormous amounts (Table 4). Much less pronounced was the respective development for Comecon countries' exports, where exports of research-intensive goods still play a minor rôle. Yugoslavia is in between, though it bears more resemblance with NICs and LDCs. Unlike the Comecon countries, Yugoslavia has managed to reduce the almost monostructural element of 1965, namely the high raw-material intensity of her exports. The share of these exports is even below that of total research-intensive goods today (it was 7 times as high as it was 1965).

28. Turning now to the indicators of market shares ("absolute competitiveness") in OECD markets, there are significant differences in regional development (Table 5): Comecon countries increasingly specialised in exports of raw-material-intensive goods; the market shares of all other groups went down. A counter-development shows up regarding LDCs and, in particular, NICs. The latter raised their presence on OECD markets in all kinds of products. Yugoslavia again takes a middle position, with successes especially in NEIRI goods and in labour-intensive goods (which seems quite an interesting dichotomy, probably pointing towards an increase in economic diversities regarding the structure of inputs and outputs).

29. Indicators of absolute competitiveness often reveal little about where a country's real comparative advantage lies, as the example of the NICs (Table 5) demonstrates. Eliminating overall effects, like a general rise in export orientation or changes in

foreign exchange regimes, leads to the following picture (Table 6): In 1985 Comecon countries' only advantage lay in raw-material-intensive goods; this should have put a strain on the foreign exchange position of these countries. In addition, the changes since 1965 had been on average not favourable for Comecon countries.⁸ LDCs as well as the NICs subgroup have their comparative advantage in labour-intensive goods - which is no surprise. The former still maintain a high, though declining, level of competitiveness in raw-material-intensive goods. Besides that, NICs have especially improved regarding EIRI goods over the past 20 years. Yugoslavia is a special case, with hardly extreme values of RCAs. Competitiveness is at its highest (in 1985) in labour-intensive productions, followed by raw-material prone goods and capital-intensive goods. She has increased her disadvantage in EIRI goods - the only region of the ones considered - and improved her really bad performance in the supply of NEIRI goods on OECD markets. The latter again makes her revealed structure of supply more similar to the LDCs and the NICs subgroup than to the Comecon countries who maintained a high level of incompetence in regard to these genuinely sophisticated goods.

30. All in all, Yugoslavia, LDCs and, in particular, NICs have similar export patterns on OECD markets as well as similar developments in the product structure of competitiveness - both very much unlike the patterns and developments of Comecon countries. This should make Yugoslavia, like the other NICs, a prime target for trade-effecting policies of the EC and of the EC countries

⁸ As a matter of fact, there have been quite dramatic changes within Comecon: the country with the best starting position in 1965 - in terms of trade performance to be expected as well as actual trade performance in 1965 - was the GDR; she lost the most ground on EIRI and NEIRI markets until 1985. On the other side there was Hungary, who, from an adverse starting position, improved her trade structures considerably. Kostrzewa (1988) demonstrated that the degree of economic and institutional orthodoxy in the socialist countries correlated negatively with changes in trade performance: the comparatively rigid (liberal) institutions and policies in the GDR (Hungary) reacted inadequately (more adequately) to the shocks on world markets in the 1970s and 1980s.

(if there are to be such policies in the 1990s), and it should make Yugoslavia, like the NICs, prone to trade-diverting effects even if there is not to be any MFA treatment, steel policy, CAP or Article 115 cases.

IV. The Trade Diversion and the Trade Exclusion Issue

31. Many of the fears articulated in non-EC countries refer to the EC '92 as a "fortress Europe", meaning that penetration of this market will be harder than before. The fear seems to have several roots, some economic, some institutional and some historical:

- (a) The regional integration after 1992 can create a large market quite independent from third countries. This again has several aspects, two of these being that, firstly, the political economy of regulation implies that the trade policy of a large region is hard to influence from outside. The often pursued ad-hoc trade policy of the United States in reaction to non-economic foreign events seems to demonstrate this. Secondly, regional integration which comprises countries with similar levels of development and similar factor endowments (the FRG, the UK, France, Denmark) and countries with differing levels of development and different factor endowments - such as the FRG and Spain, Denmark and Greece - can manage without the rest of the world. They carry out their intra-industry as well as their inter-industry type of trade independently among themselves.
- (b) The very existence of EC '92 countries differing with respect to factor endowments implies that true internal integration would change relative factor prices significantly; the Stolper-Samulson argument applies (Schmieding, 1989). And the enormous differences regarding institutional settings - compare e.g. the service sectors in the UK and the FRG alone - will put a high internal adjustment pressure on firms and factors. Lobbies will maintain that this pressure must not be

aggravated by additional pressures from outside the EC. A time for adjustment will be demanded, with the familiar routines in its wake.

- (c) Research so far has dwelt considerably on the economies-of-scale argument: the EC '92, it is argued, will be beneficial to insiders and outsiders on account of the marginal costs declining with rising output. This is a truly two-edged argument for third countries. It says that EC-internal trade will be increasingly more beneficial, and that non-EC countries will be virtually thrown out of the EC by market forces alone; worse than that, the economies-of-scale argument should also hold for third countries, whose productions would shrink and whose marginal costs would increase, thereby aggravating the losses of markets.

32. The idea of a "fortress Europe" is indeed not very far-fetched. The question is not answered, however, whether the trade-diversion effect will be significant. After all, one has to consider that there should be a trade-creation effect, leading to an increase in the EC's social product which again makes imports from third countries rise; since marginal import shares can be assumed to exceed the average import shares, the growth effect will compensate (some of) the losses. In addition, the tariff barriers among EC countries were already removed years ago; the Uruguay Round may also come up with some tariff reduction of the EC towards third countries.

33. There have been numerous studies concerned with the effects of the EEC and EFTA on trade flows, most of them written in the 1960s (Balassa, 1974). They all try to compare the actual trade flows "after integration" with those hypothetical trade flows which the regions might have had without integration. The rest comes naturally: One can extrapolate pre-integration data, either absolute trade data, or the shares of imports in apparent consumption, or the shares of internal imports of the integrating region in total imports; again, there are basically two methods of extrapolation, one is the trend (in its various forms), the

other is to estimate import demand functions. Both methods, the trend and the demand function, have to cope with the problem that integration has dynamic side-effects, such as a re-allocation over time due to changes in competitive forces, which distort the data.⁹

34. Bearing these problems in mind, one may take a look at the development of the regional trade patterns of the EC, defined as the EC 12 (the 12 members of today, Table 7) and EC 6 (the 6 founding countries of 1957, Table 8).¹⁰ I shall not try to analyse the trade-creation and trade-diversion effects, but instead measure integration or disintegration as being part of a zero-sum game, i.e. by the trade shares in total trade - one may call this a zero-sum analysis because one region's gain in trade shares is the other region's loss. Table 8 indicates that there has been a significant increase in the intra-EC trade shares after 1958; these shares almost doubled up to 1972. Some of this must be attributed to the agricultural sphere (to the buying activities of the European Agricultural Guidance and Guarantee Fund). In the industrial sphere, integration was rapid in the first years and rose steadily until 1972. Table 8 clearly indicates that then, in 1972, integration stopped and never recovered. The oil-price hikes - which can show up as a form of integration with OPEC countries - do not help to explain this development, because there was no recovering in the early 1980s when oil prices went down. The EC enlargement after 1973 has not been reflected in rising trade shares (Table 7).

⁹ Taking the trade with and among other countries or with the rest of the world as a control group has its drawbacks, too. Apart from other countries' trade policies - not to mention the possibilities of a diverging development in macro and micro-economic variables - these countries often differ in income levels, tastes and institutions.

¹⁰ The steps of the EEC integration and enlargement were the following:

- 1.1.58: EC 6 (Benelux, France, Italy, West Germany)
- 1.1.73: EC 9 (EC 6 plus UK, Denmark, Ireland)
- 1.1.81: EC 10 (EC 9 plus Greece)
- 1.1.86: EC 12 (EC 10 plus Portugal and Spain).

35. By comparing intra-trade shares in industrial products between EC 6 and EC 12 and taking the average shares of 1958 and 1959 for a reference one can calculate some ballpark estimates of the "EC 6 Integration Effect"; doing the same by taking the average shares before the enlargement of the EC for a reference one can calculate the "EC Enlargement Effect". In the first instance the differing development of trade between EC 6 and EC 12 - at a time where EC 12 did not exist - is analysed; the six not-yet members act as a control group.¹¹ In the second instance, the EC 6 provides the reference scenario after the enlargement.¹² Table 2 gives the results.

Table 2: Trade-Share Effects of EC Integration and EC Enlargement Regarding Industrial Products - Ballpark Estimates^a (% of total trade in industrial products)

	Intra EC	Comecon	LDCs	Yugoslavia
EC 6 Integration Effect	+5.87	-0.17	-1.76	+0.09
EC Enlargement Effect	+4.52	-0.37	-0.67	-0.07

^aMissing data have been crudely guessed.

Source: Tables 7 and 8.

In view of the actual trade shares presented in Tables 5 and 6 the internal trade effects in the EC are surprisingly high: abolition of trade barriers within the EC raised the intra-trade share by an average amount of almost 6 per cent; the enlargement

$$^{11} \text{ EC 6 Integration Effect} = \left(\overline{\overline{\text{IMS}}}_{60/72}^{\text{EC 6}} - \overline{\overline{\text{IMS}}}_{58/59}^{\text{EC 6}} \right) - \left(\overline{\overline{\text{IMS}}}_{61/72}^{\text{EC 12}} - \overline{\overline{\text{IMS}}}_{58/59}^{\text{EC 12}} \right)$$

where: $\overline{\overline{\text{IMS}}}$ refers to the average over time in the share of internal imports in total imports of industrial manufactures.

$$^{12} \text{ EC Enlargement Effect} = \left(\overline{\overline{\text{IMS}}}_{73/87}^{\text{EC 12}} - \overline{\overline{\text{IMS}}}_{61/72}^{\text{EC 12}} \right) - \left(\overline{\overline{\text{IMS}}}_{73/87}^{\text{EC 6}} - \overline{\overline{\text{IMS}}}_{61/72}^{\text{EC 6}} \right)$$

again accounted for an increase by 4.5 per cent. Comecon countries' exports were diverted more by the enlargement than by the original integration, whereas the opposite is true for less-developed countries. Yugoslavia does not seem to have suffered from the EC 6 integration but rather from the enlargement of the EC as far as her industrial exports are concerned; the -0.07 per cent, when related to the average share in EC 12 imports, says that some 11 per cent of Yugoslavia's exports into the EC 12 have been diverted through the EC enlargement. However, internal development in the trading regions considered may also have had some influence on the regional structures of export performance.

V. Policy Issues

36. Studies on the effects of European integration of the EC '92 kind have virtually abounded since the Single European Act came into force. This may come as a surprise for all those who believed that everything the Single Act announces is something the EC should already have accomplished since 1970. On the other hand, it is the very fact that contrary to the time schedule of the Rome Treaty neither a truly Common Trade Policy¹³ nor a Common Market has yet been established which renders the Single European Act its importance and which at the same time explains the substantial amount of propaganda invested in the EC '92.

¹³ As regards the Common Trade Policy of today, it was the West German embassy in Beijing which handed a note over to the People's Republic of China only recently demanding a reduction in the value of certain toy exports into the FRG from approximately DM 103 Mill. (1988) to DM 70 Mill. Furthermore, the PR of China has been requested to care for more "pricing discipline" with respect to exports of other toys into West Germany in order to avoid dumping procedures. Compare AVE, Außenhandelsvereinigung des Deutschen Einzelhandels e.V., Mitteilung an die Auslands-Importabteilungen der Mitgliedsfirmen der AVE, April 14, 1989. The Common Trade Policy regarding toys still seems to be that each EC country applies a trade regime according to its own preferences (with Denmark, Belgium, the Netherlands and Luxembourg having liberalised toy imports, and France, Greece and Spain maintaining a high level of protection).

1. The Cecchini Report

37. Taking the summary report by Cecchini (1988) as a pars pro toto of analyses of EC '92, one finds the micro-economic gains of 1992 broken down into four main areas:

(a) gains from the removal of barriers affecting trade	0.2-0.3 % of GDP
(b) gains from the removal of barriers affecting production	2.0-2.4 % of GDP
(c) gains from exploiting economies of scale more fully	2.1 % of GDP
(d) gains from intensified competition	1.6 % of GDP
total for 12 member states (mid-point, at 1988 prices)	5.3 % of GDP.

The barriers affecting trade (a) are mainly customs formalities and related delays. Barriers to production (b) refer to public procurement, divergent national standards, regulatory diversity and so on. (c) and (d) seem to be self-explanatory.

Apart from that, the Cecchini report evaluates the results of a macro-economic simulation. The relationship between the micro and the macro levels is not quite clear, so suffice it simply to repeat the results of the macro simulations regarding four areas:

(a) elimination of customs formalities	0.4 % of GDP
(b) opening up of public procurement	0.5 % of GDP
(c) liberalisation of financial services	1.5 % of GDP
(d) supply-side effects	2.1 % of GDP
Average macro-economic consequence of EC '92	4.5 % of GDP

The supply-side effects (d) are in this case mixtum compositum of economies of scale in manufacturing and competition effects [which was covered by (c) and (d) in the micro-economic scenario]. Besides these effects on GDP it is expected that employment will rise and inflation will go down.

38. The Cecchini analysis is based on sound studies, so it seems, of price differentials within EC countries, and of productivity margins. The rest is algebra; calculations are performed under the assumption that inefficiencies will disappear, competition will be enhanced and frontier controls eliminated. And, indeed, if the EC and the EC-member countries eliminate controls, allow internal free circulation of goods, bads, services, capital, labour, patents, etc., if technical standards are mutually accepted, if fiscal harmonisation takes place in a welfare-increasing manner there is no doubt that GDPs will increase, employment will rise and inflation will go down (*ceteris paribus*). But why did it take so long for the EC to initiate internal liberalisation?

39. From the above it follows that third countries will not have to worry because the ensuing rise in EC's economic growth gives them the chance to improve their economic position concomitantly through an increase in exports and imports. This may be one reason why third countries are hardly made mention of in the Cecchini report, except by statements such as "The removal of border controls will lead to downward pressures on prices for intra-EC traded goods ... the EC will gain in competitiveness [at constant rates of exchange, I presume] in relation to items ... imported outside the Community (Cecchini, p. 93)". Indeed, competition should increase for third countries and induce trade-diverting effects which may compensate for the positive trade effects of EC growth.

40. One may conclude that of the fields where macro-economic benefits are expected elimination of frontier controls would (1) enhance growth and lead to (2) trade diversion. Trade diversion will worsen third countries' terms of trade, reduce their output and decrease employment. However, this trade diversion effect will be compensated by (3) trade creation for third countries

through a rise in import demand and by (4) trade creation through elimination of Article 115 cases ¹⁴.

In the same vein one might also derive positive side-effects for LDCs and Yugoslavia from the opening up of public procurement (the argument being that increased internal competition for public procurement makes the competitors buy from the cheapest foreign source, which will often lie outside the EC). The Cecchini report is not too conclusive in this field because the examples chosen refer to intra-EC divergencies.

If liberalisation instead of harmonisation of rules are on the agenda, the Liberalisation of financial services will make those third countries realise comparative advantages which can build upon an already existing high rating - like Switzerland - or which can create such a high rating. A priori it seems sensible to assume that countries to whom a "socialist" image is attributed or who are regarded to be "unstable" will not benefit at all from liberalisation in this field (except perhaps in a very wide sense by profiting from a world-wide price decrease in financial services).

Of the supply-side effects the economies of scale seem to be most important. If they really matter they are a consequence of the positive growth effects calculated, not a genuine EC '92 effect. The maximum degree to which they are bound to occur in the industrial sphere is effectively determined by, among others, the price differential which exists today on account of internal frontier controls. The additional effect of EC '92 must therefore be below the costs imposed upon production by these controls.

¹⁴ Complete elimination of Article 115 would for instance mean that

- MFA quotas will be supra-national both regarding their establishment and their administration. This would imply that outsiders will have an improved access to European markets.

- Italian waivers and French as well as West German barriers to automobile imports will no longer be feasible.

The same would hold for other Art. 115 products as well.

2. Alternatives

41. However, the assumptions of the Cecchini report and others seem to be at the same time overly optimistic and overly pessimistic¹⁵, and therefore the results of the internal-market algebra, too. They may be overly pessimistic when considering the tremendous growth effects experienced after liberalisation in West Germany in the 1950s, or when comparing growth rates in more and in less liberal economies. As regards the comparative statics of the Cecchini algebra, a more realistic scenario would also have to consider some drawbacks already visible, which can be derived from the new institutional setting and from past endeavours and performances; also, some caveats seem in place.

42. Firstly, the institutional setting (cf. paras 7-11):

- (a) SEA is only partly concerned with what economists call liberalisation. Another large part deals with the opposite, such as the R&D-policy chapter and the social-policy chapter.
- (b) The chapter truly concerned with internal integration is not mandatory for the end of 1992.
- (c) The co-operation issue may involve some administrative integration, but it tends to give pressure groups a strong influence in European decision making. Pressure groups almost never act on behalf of the consumer, as the theory of political economy tells us, and, after all, final consumption is what matters in the end.
- (d) SEA says nothing about the cancelling of Article 115, not even in the "liberal" internal-market section; Article 115 can probably be expected to continue being applied for reasons of internal trade distortion. Even the White Paper remains very much in the conditional regarding Article 115 (Kommission, 1985, para 35 sq.).

¹⁵ The accuracy of such calculations seems to be well described by "Augustine's Law of the Last Figure": According to this law the first figure (before the decimal point) is almost invariably wrong, whereas each figure after the decimal point is correct in about 10 % of the cases.

(e) The convergence of monetary policies is deemed necessary by the SEA. Monetary union would deprive the backward countries of the EC of one means of adjustment. Together with the aim of reducing regional disparities this provision may turn out actually to produce regional poor houses in the EC with the need to be subsidised continuously.¹⁶

43. Secondly, extrapolation of the past may alter expectations (cf. paras 13-24):

(f) The diverging interests which the six EC countries had from the very start in 1958 have not changed much. Divergencies in interest have rather increased through the enlargement of the EC (with the Mediterranean countries changing the focal point of interest rather towards agricultural production).

(g) The accomplishments towards EC '92 have so far rather been on the harmonisation side (which also the White Paper of 1985 considered as unwelcome) than on the liberalisation side.

(h) The policies adopted in the past to ease adjustment problems have even jumped over legal hurdles in order to increase protection;¹⁷ the EC steel market is a case in point (Dicke, Glismann, 1987). In fact, analyses of trade barriers do show increasing overall non-tariff protection also within the EC.

¹⁶ It was Herbert Giersch who made the (hypothetical) proposal of giving backward regions in West Germany - like Schleswig-Holstein - a currency of their own in order to provide them with the ability to devaluate if the terms of "international trade" get too tough.

¹⁷ "Anyone familiar with the rag trade knows that the per capita quota differentials [of MFA products] are so large - for instance between Germany and France by factors of 25 to 1 .. - that access to the entire market would severely affect existing highly protected producers in France, Ireland and ... Italy ... And here the fortress begins to take shape." (Spinanger, 1989, p. 3).

44. Thirdly, the Cecchini report needs qualification in matters of method.

(i) The most crucial point seems to be the assumption of the decline in marginal costs. Despite considerable efforts undertaken since Krugman and others indicated the importance of the declining costs in international trade theory, there seems to be no sound empirical proof of this decline:

- Multiproduct firms are clearly unable to estimate their own cost functions.
- Big firms developed the idea only recently to create "profit centres" within the firm in order to simulate multi-firm competition. So there should be - if costs really decline - a compensatory effect of the decline in competition, saying that the cost decline is not immediately handed over and will thereby - through capitalisation of rents - become costs again.
- There is no correlation between market size and productivity of labour (Dicke, 1989, p. 32 sqq.).
- The rapid development regarding data processing and the transport costs of information (which is different from the economies-of-scale argument) is widely held to improve the market chances of newcomers; there are trends towards miniaturising production in the industrial and the service sector.
- In addition, the improvement of the financial markets by EC '92 and world-wide should lower costs of financing, increase the number of entrepreneurial "mavericks" and thereby may lower average efficient firm sizes.
- Scale economies can turn out to be a mixed blessing because the demand of big firms for protection (regulation) is harder for governments to withstand. In other words, the negative dynamic effects of scale economies must be taken into account.

Last but not least, we observe the failure of large systems today even more than in the past. Not only do big firms fail consistently (in West Germany, for example, subsidies typically go to the large firms), but there is also evidence that big nations become harder to manage. This should spell marginal cost increases when translated into economics.

- (j) The calculation of the "gains of removal of trade barriers" does not take into account that red-tape costs are to a large extent simply transferred from the border to the firms - where they again appear (e.g. the harmonised system of foreign trade statistics and introduction of the multi-purpose single formula did produce additional costs in the firms; Dicke, 1989, p. 30). Similar estimates exist regarding the complications of a value-added tax clearing system, where costs would simply be deviated to national authorities (Neumark, 1988).

45. My judgement would be that the Cecchini report grossly overestimates the static economic gains of EC '92; even if one is solely concerned with the issues of the internal market, as Cecchini, red-tape reductions and public procurement liberalisation seem to be overestimated, economies of scale hardly exist - and if they do, they are a consequence of the trade increase and therefore depend on it. This trade increase, however, depends again on how much internal (or external) trade liberalisation will be enacted. And here again, the sections in the SEA as well as the institutional development so far do not give rise to such an amount of optimism.

Optimism, on the other hand, seems to be justified with regard to the effects of the EC '92 propaganda. There is great interest world-wide in EC '92. This quite obviously has contributed to the investment boom of many a country today. Due to the EC '92 idea giving birth to considerable investment creation, we hopefully will not experience a comparable investment diversion after 1992.

V. Concluding Remark

46. The strategic situation for LDCs and for Yugoslavia depends on whether one adheres to the optimistic scenario of the Cecchini report or to the pessimistic one. In the first case the trade-diversion effects of the internal market will be (over-?) compensated by the growth effects on EC imports. We saw above that even in the worst case of a zero-sum-game analysis (= trade creation equalling trade diversion), Yugoslavia suffered only a 10 per cent decline of her export share into the EEC due to the enlargement. LDCs and Yugoslavia would have no reason to be apprehensive regarding 1992 (or to be particularly happy, for that matter).

47. The more pessimistic scenario, with the predominance of policy co-ordination issues and of R&D policies over the internal-market issue, of increased "social cohesion" and of the monetary union would rather weaken market forces in the EC, and thereby reduce the possible positive dynamics of the internal market. Taken together we would experience negative growth effects, trade diversion and net trade destruction regarding third countries. LDCs would be worse off, and also Yugoslavia. Yugoslavia would in this case be well advised to join forces with LDCs in the battle for liberalisation within the framework of GATT.

48. In both cases, Yugoslavia might try to improve her position relative to LDCs such as the Philipines, or Hong Kong by striving for closer integration into Europe. Since Yugoslavia is not exactly a typical market economy it may be prudent to jump on the overall East-West-integration train by applying for membership in the EFTA. This would leave Yugoslavia relatively free to pursue her own domestic and foreign policies and reduce trade barriers to EFTA and to the EEC on a reciprocal basis. The administrative strain would be less painful and the realisation of the membership would possibly be faster. Yugoslavia would, however, have to adjust in several aspects in that case: She would have to make

her currency competitive (convertibility), she would have to liberalise foreign trade, she would not be able to afford discrimination of firms according to the structure of property rights, she should be ready to guarantee the rights of foreign direct investors to repatriate moneys and to move freely within Yugoslavia.

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Region	Product Group	Raw-Material-Intensive Goods	Labour-Intensive Goods	Capital-Intensive Goods	EIRI(a) Goods	NEIRI(b) Goods
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Table 3

OECD Exports by Region and Product Structure 1965 and 1985 (per cent)

Comecon Countries(c)						
1965		11.6	20.9	20.4	12.2	34.9
1986		8.5	19.5	21.0	15.2	35.8
Less Developed Countries(d)						
1965		18.8	19.1	20.3	10.7	31.1
1986		15.5	15.6	15.3	17.1	36.5
Asian NICs(e)						
1965		8.7	30.3	20.1	13.5	27.4
1986		9.1	15.9	13.7	20.3	41.0
Yugoslavia						
1965		23.0	18.8	19.3	8.6	30.3
1986		9.6	22.4	19.2	17.4	31.4

Table 4

OECD Imports by Region and Product Structure 1965 and 1985^a (per cent)

Comecon Countries						
1965		55.1	16.6	18.3	4.7	5.3
1986		57.8	17.2	11.9	7.0	6.2
Less Developed Countries						
1965		71.0	15.2	11.8	1.4	0.6
1986		38.1	33.1	7.5	9.9	11.4
Asian NICs						
1965		38.8	43.3	13.6	2.1	2.3
1986		8.8	50.4	5.8	17.5	17.5
Yugoslavia						
1965		53.3	23.3	15.7	3.9	3.8
1986		17.5	42.7	21.3	5.8	12.7

(a) Research intensive goods where productive know-how can be easily imitated. -
 (b) Research intensive goods where productive know-how is not easy to imitate. -
 (c) Bulgaria, CSSR, GDR, Hungary, Poland, Romania, USSR. - (d) Non-OECD countries excluding: European LDCs, South Africa, Comecon countries, OPEC countries. - (e) Newly industrializing countries: Hongkong, Malaysia, Singapore, South Korea, Taiwan. - For definition of product groups see Kostrzewa (1988).

Region	Product Group	Raw-Material-Intensive Goods	Labour-Intensive Goods	Capital-Intensive Goods	EIRI Goods	NEIRI Goods
<u>Table 5</u>						
Regional Shares of OECD Imports by Product Group 1965 and 1985 ^a (per cent)						
Comecon Countries						
1965		5.5	2.1	2.6	1.6	0.9
1986		6.9	1.8	1.3	1.1	0.7
Less Developed Countries						
1965		25.6	11.3	10.3	3.0	0.6
1986		20.3	23.5	5.7	10.4	9.1
Asian NICs						
1965		2.3	3.3	1.2	0.5	0.2
1986		2.8	14.5	1.8	7.5	5.7
Yugoslavia						
1965		0.5	0.5	0.4	0.2	0.1
1986		0.3	0.8	0.4	0.2	0.3

^a Cf. Table 1 for definitions.

Source: Cf. Table 1.

<u>Table 6</u>						
International Competitiveness ^a of Regions vis-à-vis OECD countries by Product Group 1965 and 1985 ^b (per cent)						
Comecon Countries						
1965		1.57	-0.22	-0.10	-0.94	-1.89
1986		1.99	-0.07	-0.51	-0.72	-1.70
Less Developed Countries						
1965		1.33	-0.23	-0.54	-2.02	-3.89
1986		0.90	0.75	-0.71	-0.55	-1.16
Asian NICs						
1965		1.48	0.33	-0.42	-1.87	-2.52
1986		-0.04	1.15	-0.86	-0.16	-0.86
Yugoslavia						
1965		0.84	0.21	-0.21	-0.78	-2.09
1986		0.60	0.65	0.11	-1.11	-0.90

^a Defined as the log of the relation between export shares and import shares. - ^b Cf. Table 1 for definitions.

Source: Cf. Table 1.

Table:7 - Regional Trade Patterns of EC-12: 1958 - 1987

Year	Total Trade (Mill. ECU)			INTRA-EC Trade (per cent of total)			Comecon Trade (per cent of total)			LDC Trade (per cent of total)			Yugoslavia Trade (per cent of total)		
	All	Agri-	Indus-	All	Agri-	Indus-	All	Agri-	Indus-	All	Agri-	Indus-	All	Agri-	Indus-
	Products SITC 0-9	cultural Products 0+1	trial Products 5-8	Products SITC 0-9	cultural Products 0+1	trial Products 5-8	Products SITC 0-9	cultural Products 0+1	trial Products 5-8	Products SITC 0-9	cultural Products 0+1	trial Products 5-8	Products SITC 0-9	cultural Products 0+1	trial Products 5-8
1958	37249	NA	NA	35.23	NA	NA	2.92	NA	NA	29.49	NA	NA	0.50	NA	NA
1959	39468	NA	NA	37.43	NA	NA	3.28	NA	NA	28.19	NA	NA	0.46	NA	NA
1960	46711	NA	NA	37.92	NA	NA	3.26	NA	NA	26.03	NA	NA	0.48	NA	NA
1961	49539	10597	22164	40.41	32.39	60.16	3.39	NA	NA	24.72	NA	NA	0.48	NA	NA
1962	54079	11821	24882	41.75	31.63	61.65	3.38	3.96	2.04	24.16	32.46	6.29	0.50	1.11	0.28
1963	60287	12750	28087	43.04	32.67	63.00	3.43	4.23	1.94	23.39	31.99	5.92	0.58	1.17	0.40
1964	68351	13873	33026	43.65	34.32	62.70	3.11	3.38	1.83	22.68	31.14	5.89	0.49	1.05	0.34
1965	74040	14936	36937	44.86	35.94	62.69	3.38	3.92	2.09	21.99	29.76	6.12	0.51	1.01	0.38
1966	80180	15595	41837	45.90	36.32	63.00	3.46	4.22	2.14	21.49	28.98	6.65	0.52	1.04	0.40
1967	82700	15612	43647	46.59	38.49	62.91	3.65	4.75	2.10	21.33	28.45	6.36	0.58	1.38	0.39
1968	91463	15708	50505	47.78	41.45	62.64	3.49	4.45	2.15	20.84	27.24	6.65	0.57	1.19	0.45
1969	107891	17545	62571	49.81	43.95	63.50	3.33	4.65	2.16	19.68	27.07	6.46	0.60	1.04	0.54
1970	124371	19418	72980	50.29	44.20	63.92	3.20	4.05	1.92	18.90	27.69	5.86	0.58	0.92	0.54
1971	134470	20989	77976	52.13	46.80	66.45	3.19	3.90	2.03	18.81	25.13	5.07	0.58	0.90	0.58
1972	147475	23353	87594	53.83	49.62	67.60	3.28	4.06	2.13	18.02	23.61	4.88	0.68	1.01	0.72
1973	187653	29430	112584	53.43	49.36	66.22	3.32	3.78	2.48	18.49	24.00	5.58	0.66	0.87	0.72
1974	266858	33472	144385	48.27	50.37	65.19	3.21	3.00	2.45	25.26	23.62	5.85	0.47	0.52	0.61
1975	263194	36909	143537	49.49	51.66	65.44	3.47	2.82	2.45	23.08	22.30	5.40	0.41	0.48	0.52
1976	333302	44014	185377	49.34	50.83	65.17	3.66	2.56	2.47	23.33	24.44	5.81	0.46	0.58	0.56
1977	365755	50358	207787	50.75	50.92	65.47	3.58	2.15	2.56	22.84	29.54	6.06	0.46	0.54	0.54
1978	387086	52063	230003	52.24	54.54	64.81	3.56	2.26	2.44	20.35	26.16	5.93	0.45	0.53	0.51
1979	469949	56468	267148	52.04	56.02	66.15	3.65	2.13	2.32	20.83	25.29	6.34	0.45	0.51	0.50
1980	557090	60649	302371	49.28	56.38	64.61	3.68	1.92	2.20	23.20	23.66	6.80	0.39	0.49	0.48
1981	618285	68064	324792	48.53	56.87	63.47	3.76	1.71	2.00	23.37	22.75	6.82	0.36	0.43	0.49
1982	671542	76081	358887	50.06	58.12	64.45	4.08	1.63	1.96	21.56	22.87	6.68	0.42	0.47	0.54
1983	706956	80467	391423	51.67	58.63	64.05	4.18	1.61	1.86	19.61	23.33	6.75	0.51	0.57	0.63
1984	808105	88243	453992	51.66	58.16	63.03	4.44	1.73	1.90	18.78	25.12	6.89	0.54	0.50	0.67
1985	873160	95133	504264	53.45	60.23	63.77	3.89	1.77	1.80	17.86	24.55	6.57	0.55	0.51	0.71
1986	794270	94115	526781	57.88	63.02	64.75	3.13	1.60	1.75	13.55	23.12	6.33	0.62	0.49	0.73
1987	827452	94019	568614	58.90	65.20	65.07	2.96	1.67	1.60	13.11	20.61	7.08	0.63	0.54	0.73

Source: Statistical Office of the European Communities: External Trade. ONELINE, Datenbank: FRIC

Table:8 - Regional Trade Patterns of EC-6: 1958 - 1987

Year	Total Trade (Mill. ECU)			INTRA-EC Trade (per cent of total)			Comecon Trade (per cent of total)			LDC Trade (per cent of total)			Yugoslavia Trade (per cent of total)		
	All	Agri-	Indus-	All	Agri-	Indus-	All	Agri-	Indus-	All	Agri-	Indus-	All	Agri-	Indus-
	Products SITC 0-9	cultural Products 0+1	trial Products 5-8	Products SITC 0-9	cultural Products 0+1	trial Products 5-8	Products SITC 0-9	cultural Products 0+1	trial Products 5-8	Products SITC 0-9	cultural Products 0+1	trial Products 5-8	Products SITC 0-9	cultural Products 0+1	trial Products 5-8
1958	26085	4929	12115	26.02	18.44	35.74	2.59	3.10	1.45	25.81	46.11	4.52	0.51	1.34	0.19
1959	24272	5095	10309	33.30	22.10	50.30	3.39	4.32	2.00	27.18	40.37	6.36	0.53	1.09	0.25
1960	29591	5475	13559	34.31	23.69	49.45	3.30	4.14	1.85	25.30	41.66	6.30	0.54	1.30	0.25
1961	32171	5708	15289	36.41	25.31	52.34	3.36	4.88	1.63	23.40	35.72	5.74	0.50	1.15	0.26
1962	35754	6612	17458	37.51	24.81	53.40	3.36	4.37	1.77	22.71	36.61	4.99	0.56	1.20	0.33
1963	40362	7081	19927	38.92	26.37	54.88	3.37	4.99	1.61	21.61	33.82	4.58	0.69	1.65	0.42
1964	44891	7811	22798	40.21	27.37	56.10	3.03	4.09	1.48	21.78	35.10	4.66	0.59	1.32	0.40
1965	48991	8847	25088	41.69	29.69	56.44	3.21	4.76	1.60	21.38	32.43	4.85	0.61	1.27	0.47
1966	53625	9346	28751	42.74	30.23	57.09	3.36	5.12	1.64	21.01	31.56	5.68	0.65	1.33	0.52
1967	54939	9353	29596	43.98	33.05	58.16	3.66	5.60	1.62	20.91	30.33	5.37	0.72	1.82	0.50
1968	61955	9822	34858	45.85	37.98	58.44	3.42	4.93	1.72	20.12	28.40	5.52	0.67	1.32	0.54
1969	75580	11491	44610	48.07	42.09	58.94	3.24	5.27	1.78	18.76	26.91	5.63	0.72	1.24	0.66
1970	88431	12947	53429	48.40	42.06	58.53	3.14	4.67	1.84	18.15	27.25	5.39	0.70	1.11	0.65
1971	96775	14222	58015	50.10	45.28	59.99	3.24	4.66	1.97	17.86	24.70	4.46	0.71	1.07	0.70
1972	106207	16187	64639	51.66	47.96	60.66	3.31	4.78	2.13	17.35	22.84	4.41	0.82	1.22	0.86
1973	134697	20550	80883	50.41	45.11	60.24	3.40	4.55	2.23	17.90	22.62	5.06	0.82	1.08	0.90
1974	188582	22389	103152	45.59	47.43	59.03	3.33	3.58	2.30	24.80	22.19	5.58	0.59	0.64	0.76
1975	187729	25374	103323	46.03	46.12	58.10	3.56	3.37	2.31	22.50	20.24	5.14	0.52	0.62	0.66
1976	243020	31796	135465	45.30	45.22	57.34	3.70	2.94	2.37	22.73	22.54	5.59	0.57	0.67	0.70
1977	267526	36409	151107	44.82	44.42	55.71	3.65	2.48	2.55	22.95	28.15	5.91	0.55	0.52	0.67
1978	283285	37923	166139	45.97	46.63	54.91	3.69	2.56	2.48	20.32	25.09	5.77	0.55	0.51	0.64
1979	343884	40741	196972	44.75	48.37	54.33	3.84	2.41	2.44	21.06	24.30	6.10	0.54	0.55	0.61
1980	411139	44275	226314	41.64	47.66	52.41	3.98	2.23	2.32	23.14	22.73	6.59	0.47	0.46	0.59
1981	452268	48901	238125	40.45	48.44	51.46	4.18	2.11	2.18	23.75	22.28	6.53	0.45	0.55	0.62
1982	487096	55066	260725	41.66	49.41	52.10	4.63	1.97	2.12	21.79	22.21	6.51	0.52	0.56	0.68
1983	511960	58470	282446	42.55	49.24	51.44	4.80	1.95	2.03	19.55	22.71	6.47	0.63	0.65	0.79
1984	585331	64187	328045	42.23	49.38	50.34	5.04	2.03	2.06	18.76	24.05	6.66	0.67	0.59	0.83
1985	633955	70066	364220	43.21	50.40	50.33	4.42	2.06	1.94	17.85	23.96	6.52	0.68	0.61	0.89
1986	578554	68910	384043	47.63	51.81	51.22	3.51	1.84	1.87	13.47	22.62	6.22	0.76	0.54	0.91
1987	597969	68595	412567	48.01	52.73	50.87	3.26	1.89	1.72	12.91	19.47	6.92	0.78	0.60	0.90

Source: Statistical Office of the European Communities: External Trade. ONELINE, Datenbank: FRIC