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# I. THE INSTITUTIONAL ENVIRONMENT IN THE COMMUNITY AND ITS CHANGES

## A. Introduction

It is widely recognised that the traditional two pillars of growth theory - factor endowments and technology - are incomplete. Institutional arrangements are the third pillar. They affect human choice by establishing the basic rules of transactions, by specifying rights for access to scarce resources and by shaping incentives to invest, to produce or to consume. The institutional environment as a set of fundamental political, social, and legal rules governs economic and political activity.

Institutional arrangements are, in general, non-negotiable from the individual agent's point of view (Wallis, 1989). Viewed from the politicians, however, institutions can be negotiated as far as the power to alter them falls within their legitimacy. The European institutional structures, for instance, can be regarded as hierarchies in which the power to change institutional arrangements depends on where agents stand in the hierarchy. The institutional environment at the European level is designed chiefly by treaty law and by secondary law, which can only be changed by unanimous agreement of member states. Within the European Communities the scope of power for national politicians to change institutions is limited by Community law and national law as well. By forming interest groups, and by using the political mechanism, or by influencing the public opinion, it is possible also for private agents, at some cost, to induce politicians to change the institutional environment (Hiemenz and Langhammer, 1988). The new institutional economic theory (Buchanan and Tollison, 1980) predicts that changes in the institutional environment created by interested persons or groups are, in general, not optimal for a society. The reason for a non-optimal outcome is simple: interested persons or groups seek to alter institutions in order to maximise their own utility rather than social welfare. Thus, institutional change per se is not good or bad from a welfare economic point of view. It all depends on the induced welfare effects.

Since 1951 when European integration started the institutional environment for EC internal economic transactions has changed in different ways and with different impact on growth and trade. The Treaties on the European Coal and Steel Community (ECSC), the European Economic Community (EEC), the European Atomic Energy Community (EAEC) itself and their validity have been altered from time to time and thus have changed the constraints under which national politicians and non-politicians can act. On the eve of integration, the operation of the Communities was entrusted to three principal bodies[1], (1) the Council, (2) the Commission, and (3) the Court of Justice. Compared to them, the Assembly (now called European Parliament), the Court of Auditors (established in the seventies), the Economic and Social Committee, the European Investment Bank are auxiliary institutions. Yet, also these bodies have changed the institutional environment in different ways by applying or ignoring the terms of the treaties.

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[1] After the Merger Treaty was set into force on July 1, 1967 the three Communities created a single Council of the European Communities, and a single Commission of the European Communities.

## B. The Structure of the EC until the Mid Eighties

### 1. Institutions

Signatories of the Treaties of the ECSC, EEC, and EAEC were Belgium, the Federal Republic of Germany, France, Italy, Luxembourg and the Netherlands (EC-6). The United Kingdom, Irish Republic and Denmark joined the EC in January 1973 (EC-9), followed by Greece in 1981, and Portugal and Spain in 1986 (EC-12). The three enlargements of the European Communities can be regarded as institutional changes with important impacts on the economies of the old and the new member countries, and of third countries as well. The transition period of the last enlargement is still ongoing.

To understand the legalistic nature of the Community, it is necessary to recall briefly the division of labour between the three major institutions, that is the Council of Ministers, the Commission and the Court. The Council of Ministers is the principal decision-making body of the EC, which represents the governments of the member states. The Council takes the final decision on proposals presented from the Commission. Each member state has one representative in the Council. Decisions can be taken by unanimity, simple majority, or qualified majority.[1] In contrast to the voting provisions of the EEC Treaty, it has become normal practice of the Council to proceed only on the basis of unanimity. This practice goes back to the Luxembourg compromise on the 29th of January 1966. By this compromise the majority voting provision was substituted for unanimous decision to be taken in all cases in which a member country contends that its national interests are involved. The right to veto the Council's decisions is one of the institutional changes which have occurred after the treaties came into force and which have had a great influence on policy making in the Communities. The provisions with respect to

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[1] The vote of each representative is weighted; 10 each for the big four (West Germany, France, Italy and the UK); 8 for Spain; 5 each for Belgium, Netherlands, Greece and Luxembourg. 54 votes are required for qualified majority.

voting procedures were changed again in 1987 when the Single European Act (SEA) was set into force.

The role of the Commission of the EC as defined in Section 3 in the EEC Treaty is basically to ensure the proper functioning and development of the common market. By playing the role of a guardian the Commission ensures that the provisions of the treaties and the measures taken by the institutions are applied by the member countries. The Commission does not only formulate recommendations and deliver opinions. It possesses own power of decision-making and participates in the shaping of measures taken by the Council and the Assembly (European Parliament). Finally, it exerts power for the implementation of the rules laid down by the Council. The Commission presently consists of 17 members. Two of them are nominated by the Governments of West Germany, France, Italy, UK and Spain, respectively, and one is nominated by each of the governments of the other 7 member countries. Decisions are made by majority voting.[1]

The Court of Justice, being the third major player shall ensure that in the interpretation and application of the Treaties the law is observed. The Court comprises 13 judges chosen from each member state plus one from the larger member states. They are appointed by common accord of the national governments of the member states for a term of six years.

The Council and the Commission can make use of five legal instruments (Article 189 EEC Treaty).

(1) Regulation which has general application, is binding in its entirety and is directly applicable all member states.

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[1] For details see: Treaty Establishing a Single Council and a Single Commission of the European Communities, Official Document of the European Communities, No. 152, 13. July 1967.

(2) Directives addressed to member States shall be binding only as to the result to be achieved. Each Member State shall leave to the national authorities the choice of form and methods. Experience suggests that the process of implementing directives into national law takes two years time on average.

(3) Decisions shall be binding in its entirety upon those to whom they are addressed.

(4) Recommendations and (5) opinions, both of which shall have no binding force.

## 2. Objectives and Methods of Integration

Article 2 of the EEC Treaty states that the task of the Community is to "promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase of stability, an accelerated raising of the standard of living and closer relations between the States belonging to it". This objective shall be achieved by the creation of a single internal market and by a progressive convergence of the economic policies of member states. Implicitly, closer cooperation in all areas of politics with the view of a political union is the basic political objective. Within this framework, enhanced economic cooperation in the field of interventions or active management of economíes was considered to be an adequate step to achieve this objective, regardless of what economic theory suggests.

Apart from providing the power of common interference with the market process, the EEC Treaty (as well as the ECSC Treaty) calls on the governments and individuals in various ways in order to enforce the rights of free international transactions.[1] In principle, discrimination in all possible forms has to be abolished. State monopolies are not principally forbidden. However, they should not hamper competition on free trade.

The EEC Treaty provides certain exemptions from the validity of the right of an unrestricted market access within the common market. For instance, Article 36 provides that prohibitions or restrictions on imports and exports are justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeo-

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[1] The EEC Treaty which is valid for the whole economy excluding steel, coal and atomic energie enumerates in Article 3 all activities, which the European bodies shall perform.

(1) elimination, as between member states, of custom duties and of quantitative restrictions on the import and export of goods, and all other measures having equivalent effect;
(2) establishment of a common customs tariff and of a common commercial policy towards third countries;
(3) the abolition, as between member countries, of obstacles to freedom of movement for persons, services and capital;
(4) the adoption of a common policy in the sphere of agriculture and transport;
(5) the institutions of a system ensuring that competition in the common market is not distorted;
(6) the application of procedures by which the economic policies of member states can be coordinated;
(7) the approximation of the laws of Member States of the extent required for the proper functioning of the common market;
(8) the creation of a European Social Fund in order to improve employment opportunities.
(9) the establishment of a European Investment Bank to facilitate the expansion of the Community by opening up fresh resources.

As can be seen from this enumeration, the power of the EEC is not restricted to set the institutional constraints adequate to a market economy. Common policies in the sense of joint interventions in areas like trade with third countries, transportations and agriculture are also conferred upon the Community.

logical value; or the protection of industrial and commercial property. Furthermore, article 73 authorises member states to take protective measures in the field of capital movements "if movements of capital lead to disturbances in the functioning of the capital market in that state".

## 3. Application of the Community Law until the Mid Eighties

From a legalistic point of view, all activities conferred upon the EC institutions have been inaugurated within the time table set out in the Treaties. Different decisions of the Court of Justice have exhibited that, in particular, the terms of the EC Treaty with respect to the Common Market are valid. The Court has stated that the Common Market was completed in 1970, 12 years since the Treaty of Rome entered into force on the 1th of January 1958.

However, the legalistic interpretation widely differs from the economic one. The latter focus on the existing barriers to cross-border transactions which are not in accordance both with all the provisions of the treaties and their objectives (Dicke et al., 1987).

## 4. Common Market Policy until 1985

By mid 1968 the customs union was completed when internal tariffs were removed and the common external tariff be introduced. Yet, this progress was limited to tariffs only, not to non-tariff barriers (NTBs). Only part of the latter barriers were defined on an EEC-wide basis, whereas the majority was still implemented on a national basis. National barriers while violating the principle of the customs union, required intra-EC controls of trade in order to discourage trade deflection through other countries (Art. 115 EEC Treaty). Thus, to the extent that EC member countries resorted to national barriers, significant discrepancies between countries existed as to the amount and structure of protection (Spinanger, 1989). To put it briefly, a customs union did not and does not exist today, irrespective of what the legalistic interpretation of the common market says.

Apart from explicit national quotas, there has been a large number of other NTBs impeding intra-EC trade. The Community has made several attempts, for instance, to harmonise laws, regulation, administrative actions, norms and standards differing by member states in order to cope with border barriers arising from such NTBs. However, progress has been small and cumbersome. With respect to anti-trust policy the EEC was quite successful in those areas which were not exempted (transportation for instance). Yet, anti-trust policies have often been abused as an instrument of industrial policy. With respect to public procurement and subsidy payments, however, the EEC did not meet the objectives of the Rome Treaty. Subsidies, measured both by cases as well as by volume, increased. Also in the field of common sectoral policies integration can hardly to be regarded successful in an economic sense.

In the steel sector, for example, attempts to provide a free market organisation were made only until 1962. However, already at that time national measures aiming at discrimination between national steel producers by means of subsidy payments, rising year by year, were already tolerated (Glismann, Dicke, 1987). These attempts were followed in the sixties and seventies by a joint steel policy, pursued with the view of indicative planning investment, production and trade. An even further regulated system of limited production and export quotas etc. was implemented in order to cope with the crisis of the early eighties.

The agricultural sector is a case sui generis. Here, the EEC agreed already in 1962 on a well-coordinated group of regulated markets instead of common competition rules or a joint regulated market, thus continuing the previously national interventionist policies. The majority of the various joint market regimes for grain, meat, milk etc. were put into effect by 1968. In addition, it was agreed on that the costs of this policy were to be financed out of a joint fund. These market regimes resulted in steadily rising prices and in increased trade barriers vis-à-vis third countries through the use of tariffs, export subsidies and import fees. This system of regulated markets was affected also by various non-tariff barriers, continuous subsidy payments on a national basis, which were left exempted from EC control, as well as on an EC-wide basis as part of regional and structural policy programmes.

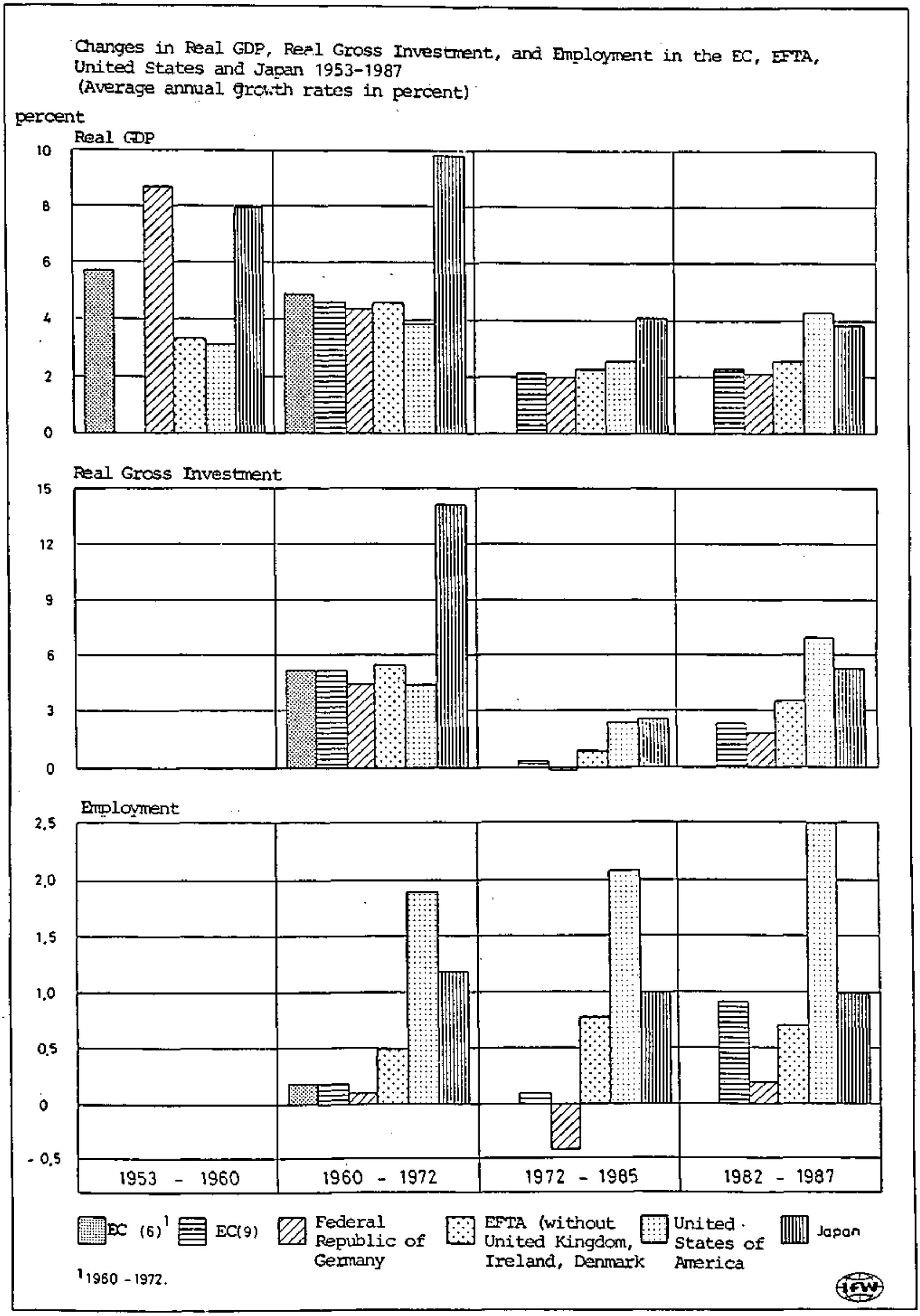
Finally, trade in services was strongly regulated when the EEC was founded. While investments of service companies across national borders were allowed without restrictions, the supply of services itself, in general, was only allowed according to national standards (country of destination principle). This situation did not change significantly until the mid eighties.

## 5. Assessing EC-Induced Growth Effects

Apart from the problems in identifying and measuring the impact of policies in general there is a problem of identifying the specific EC contribution to economic growth in particular. As EC policies have been pursued along with measures determined at the national level, the discrimination between the impact of various measures is difficult. Thus, any evidence on the impact has to consider the complexity of causality patterns and thus the lack of a straightforward approach.

As a first rough approach, comparisons of growth rates of real gross domestic product, employment, and real gross investment in the EC, the European Free Trade Association (EFTA), the United States and Japan suggest that since 1972 growth of real GDP within the EC slowed down more strongly than in the countries of reference (Chart 1). Other industrial countries outperformed the EC also with regard to employment and investment. However, it

Chart 1


Changes in Real GDP, Real Gross Investment, and Employment in the EC, EFTA, United States and Japan 1953-1987
(Average annual growth rates in percent)
percent
Real GDP
10
8
6
4
2
0
Real Gross Investment
15
12
9
6
3
0
Employment
2,5
2,0
1,5
1,0
0,5
0
- 0,5
1953 - 1960
1960 - 1972
1972 - 1985
1982 - 1987
EC (6)[1]
EC(9)
Federal Republic of Germany
EFTA (without United Kingdom, Ireland, Denmark
United States of America
Japan
[1]1960 - 1972.

must not necessarily be the EC which should be blamed for this lack of achievement. A disappointing performance could be due to pronounced policy failures on a national basis, especially in the early stage of the EC when national sovereignty was unrestricted in all major policies.

A more direct contribution of EC policies can be revealed in the above mentioned areas of agriculture and steel, in which common policies dominated for the very beginning.

European agricultural policies have resulted in

- increasing shares of agricultural products against more competitive foreign ones;
- increase in fiscal and social costs;
- relative decline of incomes in the agricultural sector relative to the rest of the economy.

The impact of European (and German) steel policies has been negative on any account. The adverse effects include

- a misallocation within European steel production towards the less efficient producers;
- an exponential increase of the capital stock in spite of an exponential decrease of the rate of capital utilisation between 1955 and 1980 (Dicke, Glismann, 1984a) and
- a trade diversion to the detriment of third countries

Summarising the available evidence, there is some reason to assume that from a macroeconomic point of view the EC policies did not deliver the objectives in terms of an accelerated increase in the standard of living or stable and balanced growth. Yet, it is noteworthy that in the sixties the Community performed fairly well, when in particular tariff barriers in the wake of GATT-rounds were reduced (Giersch, 1988). The hard test came in the seventies when the external environment for growth deteriorated visibly after economic shocks hit all major economies. During this period the various national policies reducing the scope for market activities were not reversed but accompanied by

EC policies along the same lines. Protection against third countries rose together with regional and sectoral transfers (Page, 1987). Thus, while at the national level domestic pressure groups pushed for "institutional" changes at the EC level, pressure groups assured that attempts for "income maintaining" dominated the adjustment. In the eighties, however, "exit" and "voice" which Hirschmann (1970) identified as responses to decline in firms, organisations and States came into play. "Exit" in terms of capital outflows and "voice" in terms of election results in favour of market-oriented politicians had a feedback on the European institutional arrangements. As national authorities of most member countries became more market-oriented so did the European policy-making bodies.

## C. 1992: the New Institutional Approach to the Completion of the Internal Market

In view of the sluggish economic growth in the European Communities and the slow progress in the field of political integration the European Council of the Heads of the States reaffirmed at the Stuttgart Summit in June 1983 that the original objectives of a European Union had not changed and, furthermore, stressed the need for a new initiative to complete the internal market. Policy action was launched two years later. At the Luxembourg Summit of December 1985 the heads of the member states signed the Single European Act which after ratification on 1st of July 1987 significantly changed the institutional environment for European policy making. The SEA changed, modified and limited the powers of national European authorities. Prospects for the abolishment of obstacles to free internal trade in goods and services and free movements of capital and labour were improved by a new concept for market integration proposed by the Commission of the EC in its White Paper on the Completion of the Internal Market. As it was the jurisdiction of the European Court of Justice (ECJ) which visibly contributed to this development, some decisions of the Court are discussed in the following.

## 1. Jurisdiction of the European Court of Justice

By several decisions the ECJ has strengthened the individual right of free exchange of goods and services even in cases where national authorities stated that free market access would be harmful to the public. In the Cassis de Dijon suit instigated by the Westgerman wholesale chain Edeka the ECJ decided in 1979 that restrictions or prohibitions on imports would only be justified if public interest (security, health etc.) would be affected. If the public would not be jeopardised and qualities of imported goods and services diverge from those which are prescribed by national laws the information to consumers about the different qualities would fully suffice. In effect, by this decision the ECJ replaced the country of destination principle by the country of origin principle. This means, that a product or service legally brought to the market in one member state can automatically be sold across borders within the Common market. The Cassis de Dijon approach has been applied to quite a number of controversial cases decided by the Court eg. Italian pasta, German beer, German sausage, etc. It was also tried to apply the country of origin principle to the sales of services, for instance, insurance or financial services. In these cases the ECJ made provisos. It argued that trans-border selling should be limited to customers big enough to make a proper evaluation of the soundness of the contracting counterpart. This judgements confirmed the stance taken by the Council and the Commission that there must be limits to the validity of the country of origin principle. These limits should be defined by directives. In three other cases instigated by transport companies the ECJ decided that the general provisions of the EEC Treaty especially Articles 85 and 86 (competition policy) have to be applied unless the Council establishes a common policy in the field of transport.

## 2. Proposals of the EC Commission

With reference to the Jurisdiction of the ECJ the Commission of the EC in its White Paper recommended to no longer adhere to the traditional concept of ex-ante harmonisation of national laws. Instead of harmonising national prescriptions in detail, the principle of the country of origin should be applied as far as possible. Thus, different laws, norms and standards should mutually be recognised. The Commission argues that, in principle, all national authorities are willing and capable to protect consumers and the public in general in the fields of health, security, deceit, overreaching etc. Only in cases of major health and security needs a common law providing minimum standards should be made. This new approach should be applied to laws and regulations relating to goods and services. The designing of common norms should be left to European private organisations. As to public procurement the opening of national markets should be enforced chiefly by providing transparency on the announcement and procedures of procurements.

## 3. The Single European Act

In the Single European Act which amended the EC treaties member states made a new effort to forge European integration ahead. The objective of attaining a single European market is flanked by policies which the SEA pinpointed as necessary to complete the internal market.

The SEA entails five flanking policies: (1) cooperation in economic and monetary policy; (2) paying particular attention to encouraging improvements in working conditions, (3) developing and pursuing actions leading to the strengthening of economic and social cohesion in the Community; (4) strengthening the scientific and technological basis of the EC; (5) actions relating to the environment. Furthermore, the SEA provides a new division of power between the Community institutions. A new procedure relating to the cooperation between the European Parliament (EP), the Commission and the Council is introduced aiming at strengthening the role of the EP in the decision making process.

It is important to note, however, that the new deadline (31 December 1992) set for the completion of the internal market does not create an automatic legal effect as the conference of the representatives of the Government stated. The SEA defines the internal market as an "area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with provisions of this treaty." This is not a new definition. What is new, is the word internal market, the previous term was common market. Of crucial importance is the term "in accordance with provisions of the treaty". The SEA has altered these provisions and it is to assume that it depends chiefly on the new provisions whether the objective of the completion of the internal market will be achieved on schedule.

An important change with respect to the harmonisation of law can be seen in the replacement of the principle of unanimity voting within the Council. Qualified majority voting is provided for decisions on (1) any autonomous alteration or suspension of duties in the common customs tariff, (2) provisions to nationals of a third country who provide services and who are established within the community, (3) decisions on whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport, (4) directives on capital movements, (5) measures for the harmonisation of laws, regulations, or administrative actions in member states which have as their object the establishment and functioning of the internal marketprovisions relating to the free movement of persons, taxes, rights and interests of employed persons are exempted from majority rule; in these areas, the SEA prescribes unanimity.

With reference to these new provisions it has been expected that the process of harmonising national laws, regulations or administrative actions in member states is accelerated and thus an area without border booms will be realised within the time frame set in the SEA. However, the optimistic mood could be dampened by other provisions of Article 100a of the SEA: (1) The Commission will take as a base a high level of protection concerning health, safety, environmental protection and consumer protection: (2) If, after the adoption of a harmonisation measure, a member state applies national provisions on grounds of major needs referred to in Article 36, or relating to protection of the environment or the working environment it shall notify the Commission of these provisions. The term "high level of protection" could be abused by national authorities. For instance, by pretending to prevent consumers from food and service shortages authorities have set high prices in favour of German farmers and insurance companies. Taken abuse apart, a high level of protection may be harmful for those member states, which on account of diverging preferences or low overall productivity do not want to bear the costs of high levels of protection.[1] If these countries decide in favour of lower levels of protection the effort to abolish internal barriers to trade could fail. The result is that national authorities are allowed to apply national provisions on grounds of major needs even in more cases than before the SEA.

## 4. The Completion of the Internal Market: Programme and Progress

In this paper the process of attaining the internal European market is seen separately from the other five objectives resp.

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[1] To meet with higher security or health requirements, for instance, in the area of working conditions firms have to install new equipment or to engage new staff. The costs of these measures diminish their returns. In effect, firms are less capable than otherwise to invest or to pay dividends or wages and salaries. If the opportunity costs of the introduction of higher protection levels exceed an induced increase of utility then welfare declines and member states are well advised to veto proposals for such a common law.

policies which the SEA demands to implement. In its fifth progress report of 28 March, 1989 concerning the implementation of the Commission's White Paper the Commission said, that the decision-making has accelerated considerably primarily due to the changes in procedure and partly due to its new approach of combining mutual recognition with harmonisation. The Commission has also decided for the moment not to present certain legislative proposals foreseen in the White Paper. These and other changes cut the number of proposals to 279 by June 1989. In the meantime the Commission has added three new proposals in the area of public procurement and services. Thus the total number of proposals now reads 282. About 90 per cent of these proposals have been already submitted to the Council, which has finally or partially adopted 151 directives, regulations, decisions and recommendations. The Commission classifies the total of 151 finally or partially adopted proposals into

47 measures removing physical barriers
100 measures removing technical barriers
4 measures removing fiscal barriers.

By far the most measures hitherto adopted have been decided by applying the majority voting rule. By contrast, no major decision has yet been made in the areas which require unanimity, i.e. taxation, free movements of persons (Citizens' Europe) etc. In its fourth progress report the Commission had claimed that specific decisions must be taken still in 1989 to demonstrate the credibility of these objectives too. However, by now the Council has not changed his reluctant attitude. In December 1989 it commissioned drafts for the right of asylum and for the control of persons at the outer borders of the EC. These drafts should be worked out by the end of 1990. A common law in these areas is considered to be a neccessary precondition for the abolition of frontier controls on people which cross borders within the EC. In view of the slow progress towards citizens' Europe France, West Germany, Belgium, Holland and Luxemburg decided to forge ahead. On June 19th 1990 in the village of Schengen in Luxembourg they signed an accord to abolish all mutual border controls on persons by 1 January 1992. The rest of the Community is not expected to catch up by 1992. Regarding the Commission's proposals for the removal of fiscal barriers the Council has rejected them in October 1989. Member states declared to adhere to the destination principle as they did in the past without giving any concrete detail on how and when this principle can be applied in a way that makes border checks superfluous and at the same time increases efficiency in the overall economy [Pelkmans and Sutherland, 1990]. Although the Council is lagging behind the time table it had committed itself in the SEA the member states seem to have problems with the implementation of the Community law. The Commission reports that of the measures which Member States should have implemented by now only 21 have been incorporated into the national legislation in every member state. If the States do not accelerate the implementation of Community law the credibility of Europe 1992 will suffer. As the Commission points out in passing the uprising European legal framework is also jeopardized by member states which do not comply with the decisions of the European Court of Justice. In November 1989 the Commission counted 48 decisions of the Court which member states denied to enforce.

The proposals which have been already adopted are not of equal importance. The Commission regards the free circulation of capital and the general recognition of diplomas as the most striking progress. To be sure, this judgement may be shared by economists, politicians and businessmen, but what can be said on those measures which are not regarded as most striking? If the Commission's stance is taken seriously that the country of origin principle is the superior approach in all cases where major needs with reference to public health or security do not come into play, then doubts will arise on whether striking advances have been made at all. In Appendix Table 1 an attempt was made to evaluate the White Paper proposals of the Commission which the Council has definitely or partially adopted or reached common positions. 112 measures are concerned with harmonisation, although the harmonisation of quality differentials could have been left to market forces when transparency is provided and the directive on liability law is enforced in member states. Many decisions refer to trivial points, e.g. composition of jam, coffee extracts, chicory extracts and pedigree sheep and goats, safety of toys etc. About 23 decisions can be considered to have strengthened the right of citizens to decide themselves - through transborder selling, buying and investing - what national qualities of goods and services are in their interest. 16 measures are aiming at improving mutual information or avoiding negative technical externalities. A breakthrough towards an area without internal frontiers still demands far-reaching decisions in the fields of taxes and free movements of persons. Here, the unanimity voting rule has to be applied. Last but not least decisions have to be made in the field of goods originating from third countries which are exempted from the common treatment principle with reference to Article 115 EEC-treaty. Both the SEA and the White Paper say little about third countries. However, prospects for decisions which do not harm third countries are presently less gloomy than in 1987 when the internal market program started. This assumption is corroborated by the general European-wide economic recovery which will dampen protectionist claims.

## 5. Implementation of Flanking Policies

On 1 July 1990 the first stage of the so called Delors plan (Report on Economic and Monetary Union in the European Community, 1989) will start. That was decided by the European Council at its meeting in Madrid in June 1989. In this first stage economic and monetary policy will be coordinated within the existing institutional framework. The Council of Economic and Finance Minsters (Ecofin) should survey economic developments and policies on the base of aggreed indicators and should give recommendations for correcting national policies in cases where performances were judged inadequate. The Ecofin should also provide for concerted budgetary action by the member countries. In the monetary field the Committee of Central Bank Governors should among others express opinions to individual governments and the Council of Ministers on policies that could affect especially the functioning of the EMS. The Committee would express majority opinions which could be made public but which would not be binding at this stage. At its meeting in Strassbourg in December 1989 the European Council decided also to hold a conference at the end of 1990 which should prepare a new treaty for a transfer of decision-making power from the Member States to the Community. Only when the new treaty had come into force the second stage could begin. In this stage the basic organs and structure of the economic and monetary union would be set up.

To strengthen the economic and social cohesion the European Council on its meeting in Brussels in February 1988 decided to increase the financial means of the structural funds from ECU 7.7 bn in 1988 to ECU 14.5 bn in 1993 (at prices of 1988). The greatest share (about 63 percent) is assigned to the promotion of the development and structural adjustment of regions with a GDP per capita less than 75 percent of the EC average, 10 percent is earmarked for the restructuring of ailing industries in regions with above average unemployment, 17 percent for measures which are to reduce unemployment and 6 percent for the development of rural areas and the promotion of food processing and food marketing. As the structural policies of the EC have to be complementary to national policies the EC Commission encourages member states or regions of states to submit their plans for promoting regional developments and correcting structural imbalances. In the case of the European Funds for Regional Development the Commission has already indicated how it wants to distribute 85 percent of the total cash among the member states [Commission, 1989a]. As to the other two structural funds (European Social Fund and European Agricultural Guidance Fund) the Commission has obstained from announcing the regional distribution of funds.

To "strengthen the scientific and technological basis of European industry" [Article 130 f to g of the SEA] the Council of Ministers launched a multi-year framework plan in 1988. This plan comprised a 37 programme research scheme for which ECU 3.9 bn was earmarked. In December 1989 the Council adopted a third multi-year framework plan. It provides to spent ECU 5.6 bn to back cross-border research in the five years to the end of 1994. The plan which is split into six main programmes allocates ECU 2.2 bn to information and communication technology, ECU 0.81 bn to energy research, and ECU 1.26 bn to life sciences, environment research, cross-border exchanges, and training of scientists [EC Commission, 1989b].

As to the objective of encouraging improvements in working conditions the Commission has taken care of it in its proposals for the completion of the internal market. In different directives which have been already adopted by the Council (s. Appendix) minimum health and safety standards for workers were set. By now, concrete steps to establish enforceable workers' rights were not taken. The European Social Charta which does not provide binding rules was not aggreed upon by the heads of member states at their Strassbourg meeting in December 1989.

Until the end of 1989 about 200 directives were enacted which aim at protecting environment. Well over half of them have been widely implemented by member states. However, many directives have not been properly translated into national law or the detailed standards they lay down are not being observed. Therefore, the EC Commission has claimed to become entitled to force member states to comply with Community's environment laws. It proposed to set up an environment agency which shall collect environment related data. The Council accepted this proposal on 22 March 1990. The European Assembly's claim to give the agency the right to police environment standards within member states, however, was not (yet) followed by the Council.

# II. THE EXTERNAL DIMENSION OF "EUROPE 1992"

## A. Europe 1992 and Changes in the International Trading System: A Simultaneity Problem

Non-EC member countries in general and developing countries in particular have frequently raised concern about the completion of the internal market. Studies stressing its positive effects on growth, structural change and import demand widely failed to dissipate the fear that the Community would be tempted to reduce competitive forces to the detriment of third countries. Basically, this argument extrapolates past experience with EC protectionism and receives further support from uncertainty about the stage of integration after 1992. In particular, what matters is that

- the SEA does not reaffirm the obligation laid down in the EEC Treaty to promote trade between member states and third countries. In the White Paper the Commission argues that third countries shall not be allowed to participate in the advantages of a larger common market unless they make concessions;

- the Cecchini-Report [1988] as well as the empirical studies presented in the so-called Emerson-Report [The Economics of 1992, 1988] focused on the internal effects and visibly neglected the external ones;

- the common trade policy of the EC can be subsumed under those policies with the largest amount of instability, nontransparency, and conceptual deficiencies [Pelkmans, 1986:69];

- differences in the protection level between individual member countries are still sizeable and that compromises towards a common protection level are highly disputed in some sectors;

- the effects of liberalising factor movements and trade in services escape much more from forecasts than did merchandise trade effects some twenty years ago when the impact of the customs union was estimated (trade creation and trade diversion).

Finally and most importantly, uncertainty is enhanced by the fact that parallel to the "operation 1992" four other operations have to be implemented which determine the absolute level of market accessibility for third countries. In principle, they are independent from the completion of the single market but have often been evaluated as an integral part of the integration process.

The four events comprise the completion of the Uruguay Round scheduled for end 1990, the reform of the Generalized System of Preferences (GSP) after 1990, the principles of trade in textiles and clothing after the expiration of MFA IV in 1991, and finally the new Lomé Convention to be negotiated in 1990.

Whereas each of the latter events has a direct impact on prices and market entry of extra-EC imports, operation 1992 influences changes in internal prices. Altogether, the five events determine the critical parameter of competitiveness, that is the changes in relative prices between imports and domestic substitutes and exports. Countervailing effects are possible and the net outcome is highly uncertain especially if the Community should try to link some events in a package approach.

As a result, the following discussion is scenario-oriented and not a forecast. Forecasts are not possible given the fact that the core of the internal market approach will be liberalisation of services where very little information is available on the initial amount and structure of intra-and extra-EC trade in services.

## B. Possible Effects on Developing Countries' Merchandise Trade

### 1. Export-enhancing effects

There is a large number of possible consequences of Europe 1992 on developing countries merchandise trade with the Community and with the world. They differ by income levels of developing countries, institutional and non-institutional groupings (colonially-rooted preferences) and by types of effects with respect to the latter export-enhancing, export-redistributive and export-suppression effects can be singled out as well as some further - mostly indirect - effects via changes in terms of trade and exchange rates (see synopsis table). Among such effects export-enhancing effects due to higher economic growth in the Community are frequently cited but are controversially discussed as far as their magnitudes are concerned [Davenport, 1989; Matthews and MacAleese, 1989]. Assessment of export-enhancing effects depart from estimates on integration-induced additional growth because of scale effects and declining transaction costs in internal trade. Such estimates on growth effects range between 4.5 per cent over a five years period [Economics of 1992, 1988, Part A] and 2.3 per cent over the same period [Bakhoven, 1989]. They have in common that they fail to consider dynamic effects of structural change after 1992 but instead focus on cost reductions (process innovations). A 1 per cent additional growth per year can be assumed as a reasonable yardstick and serves as reference measure for import demand elasticity.

Yet such elasticities estimated for all developing countries differ from those measured for individual countries and subregions as a result of differences in economic policies pursued by the countries. Policy-induced market segmentation such as preferences may cause a further spread in demand elasticities. With respect to developing countries, there is reason to assume that gross demand elasticities estimated ex post for developing countries are higher than those assessed for all extra-EC suppliers. This hypothesis is based on the observation that during the se-

Synopsis Table - The Impact of Europe 1992 on Developing Countries' Merchandise Trade

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**(1) Export-enhancing effects**

a) Internal liberalisation fuels demand for products exported by developing countries

b) Elimination of national excise taxes on cocoa and coffee

**(2) Export-redistributive effects**

a) Explicit effects: national import restrictions with preferential elements are abandoned (banana case)

b) Implicit effects: preferential colonial connections are phased out (Franc Zone and Commonwealth)

c) Better off developing countries outcompete least developed countries

**(3) Export-suppression effects**

a) Trade displacement (economies of scale)

b) Trade diversion proper (changing relative prices between imports and domestic substitutes because of declining prices of the latter)

c) Import reduction due to higher efficiency in the EC (resource-saving technological innovations, scale economies)

d) Implicit effects of higher health and environmental standards (canned food, commodities)

**(4) Further effects**

a) Terms of Trade effects (EC revitalisation may lead to downward pressure on export prices in international markets, ToT gains for developing countries)

b) Exchange rate effects (inflow of capital into the EC - which is not met with the export-induced outflow of capital - leads to an appreciation of the ECU vis-à-vis the $ and the Yen and improves the competitive position of developing countries against Spain and Portugal)

c) Effects on competition for private risk capital ("investment diversion" to the detriment of non-EC members)

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seventies and eighties developing countries in general and some countries in particular (e.g. Korea) succeeded to raise their share in apparent consumption of all OECD countries [OECD, 1986]. This holds true for those countries in particular which achieved rising shares of non-traditional products in their export supply. As a result, it does not come as a surprise that own estimates [Langhammer, 1989b] arrived at higher ex post estimates of EC demand elasticities in manufactured imports from developing countries (in the range of 5) than those gained for manufactured imports of industrial countries <u>in total</u> [Goldstein, Khan, 1985, 1986; Davenport, 1989: 7].

Taking such high ex post elasticities as a yardstick for estimates of trade creation would mean that - under the assumption of 1 per cent additional growth in the EC - real manufactured imports would rise by 5.5 per cent annually, that is by 2 Bill. US-$ in current prices 1986/87 or - in terms of world manufactured exports of developing countries in 1986 - by slightly more than 1 per cent.

This growth effect has to be confronted with estimates on the static trade effects due to a "once and for all" change in relative prices between domestic supply and imports. The Emerson-Report [1988: 180-82] 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 purely static trade diversion effect in the range of 10 per cent of the initial level (extra-EC imports 1985) for all products and cumulated over two stages. Related to the amount of EC manufactured imports from developing countries in 1985 and compared to the growth-induced additional import demand, the "once and for all" reduction of imports from developing countries would amount to approximately 2.3 Bill. US-$, that is slightly more than the value of additional import demand for <u>one</u> year estimated above. Thus, over a period of five years additional import demand is expected to exceed the trade diversion effect by more than four times.

Of course, this estimate extrapolates favourable export trends from the past and will have to be revised should the import propensity decrease after the completion of the internal market. In particular, "dynamic" trade diversion due to efficiency gains of EC suppliers competing with those from developing countries could threaten exports of external suppliers at least to the same extent as "static" trade diversion [Davenport, 1986: 6].

Export-enhancing effects could also arise from tax harmonisation if national excise taxes on coffee and cocoa e.g. in Denmark and West Germany, would be abandoned [Davenport, 1988; Matthews, MacAleese, 1989].

## 2. Export-redistributive effects

The completion of the internal market may lead to a redistribution of developing countries' exports to the Community among developing countries themselves. There are four different roots of such shifts which are assessed as especially damaging for least developed primary commodity producers [Matthews, McAleese, 1989].

First, some developing countries still enjoy colonially-rooted privileges in former metropolitan member states in the Community, as in the UK, France and Italy. Such colonial ties are still alive in products like bananas, sugar, and rum as they became institutionalised through quotas fixed in the appendix protocols of the Lomé conventions. They clearly conflict with the single market target and hence pose difficult problems as the Caribbean and African countries affected belong to the poorest ones and depend in their exports on such products. For instance, even a 20 per cent preference margin for ACP bananas over Central and South American bananas which would be the outcome after 1992 is regarded as insufficient to enable ACP producers of bananas to compete with the large Latin American plantations which are run efficiently by multinationals [Davenport, 1988].

Secondly, colonial patterns of trade in general are likely to vanish. They were established by traditional foreign direct investment, colonial business communities, monetary co-operation (Franc Zone) as well as metropolitan-type of marketing channels and are bound to be superseded by more homogeneity in geographical import patterns between EC member states after 1992. This process is supported by the growing unwillingness of the former metropolitan countries to assume financial responsibilities for defaulting countries.

Thirdly, more advanced developing countries are expected to exploit options of the single market better and more rapidly than more backward countries [Frisch, 1989]. This is expected to be especially relevant for the different speeds of adjustment in both groups of countries.

Fourthly, more EC-wide competition between product standards because of the mutual recognition principle may lead to shifts between exporters of substitutes. For instance, a Community-wide acceptance of vegetable oils in chocolate and ice cream could have implications for cocoa-exporting countries and for oilseed-producing countries with relative gains and losses to different countries.

## 3. Export suppression-effects

Fears about fortress Europe are associated with export suppression-effects. Such effects may materialise either because of enhanced structural change within the Community or because of additional policy-induced barriers to trade. Determinants of the former category are introduced in the synopsis table, for instance scale economies, static trade diversion and incentives to resource-saving technological innovations. Other influencing factors could be more rapid growth of service industries with a lower import content than in manufacturing industries and the completion of the full integration of the two major competitor of developing countries, Spain and Portugal, into the EC-10. The latter is a process running parallel to Europe 1992 and will be finished by 1993. Each of these developments could exert some detrimental effects on the competitiveness of developing countries' exports in the internal market, yet in no way necessarily and for each country to the same extent.

The other category of policy-induced barriers to trade brings us to the core of fortress Europe perceptions. It comprises mainly two aspects: first, increments to Community-wide restrictions and secondly, the replacement of remnants of national restrictions by Community-wide restrictions being more protectionist than the current alternative, that is the side-by-side of different national regulations.

The first aspect could gain some relevance in standards and norms though most of them are not yet Community-wide. However, there will be pressures to tighten inspections of plant health, animal diseases, "human health relating to animal products", stricter rules for labelling and additives, and hygiene standards for tinned meat, fruits and juices in the "laxer" member countries. Of the 300 measures outlined in the Commission's 1985 White Paper, no less than 74 concern veterinary and phytosanitary regulations. Altogether, they would not only mean higher costs of tests and controls imposed on developing countries' exporters. Perhaps such costs could be fully outweighed by the advantage that the foreign supplier would only have to satisfy the standards of one member state before circulating the good freely within the Community (mutual recognition principle). Yet, what weighs more heavily is that substantial and costly product modifications would be needed to enable, for instance, Zimbabwe's tobacco industry to meet low-tar standards set by Brussels or Togo's phosphate exporters to satisfy low-cadmium norms [Matthews, McAleese, 1989, p. 7].

The second aspect concentrates on the abolition of national quotas and the famous Art. 115 of the EEC Treaty which helps to enforce them. Apart from the "status quo" scenario that the Commission would not succeed to abolish national quotas and the underlying Article until end 1992, there are two scenarios possible. Either national quotas are dismantled without any substitute (optimistic scenario) or there is substitute in terms of a Community-wide quota. The latter has been labelled "neutral" (Langhammer, 1989b) but it could change into "pessimistic" if the administration of a Community-wide quota would be as restrictive as the handling by the most restrictive member state. Relatively liberal member countries would then lose their autonomy not to control their quotas. Under this scenario even a Community-wide quota which equals the sum of national quotas would be worse for developing countries as far as their volume of exports is concerned. Due to changing prices in formerly restrictive and less restrictive member countries, export earnings, however, could nevertheless increase. In addition, economic rents of oligopolistic suppliers exploiting the consumer surplus by market segmentation may even dissipate.

Candidates for Community-wide quotas are "hyper-sensitive" MFA-products, footwear, consumer electronics, ceramic tableware and, finally, cars. Cars are a case sui generis and the most important test case for the completion of the internal market in merchandise trade. The common treatment of car imports is made much more difficult than that of other imports not only because of the political and economic weight of the European car industry. What matters even more is that the enormous range of national measures which comprises instruments which are simply incompatible and which therefore cannot be transferred into a common "numeraire" such as a tariff equivalent. To mention some of them, there are official quotas, semi-official ceilings (imports under "surveillance"), private VERs, different indirect tax rates and finally open markets, like West Germany as the most important one. There is reason to assume that the search for a compromise could end in a private VER with a monitoring and surveillance procedure but this would shift the problem only from

trade policies to competition policies without solving it.
With respect to developing countries and NIEs, the issue of access to the European automobile market after 1992 has direct relevance for the Korean car industry. For a larger number of countries, however, this issue bears indirect importance if they are producers of components and spare parts. Minimum value added requirements for imports and local content rules for production within the Community add to the complexity of a "common" policy in this industry.

## 4. Further effects

There are three effects listed under "miscellaneous" which are discussed in the literature. The first one refers to an assumedly downward pressure on international prices for manufactures due to regained vitalisation of the European industry becoming increasingly competitive in extra-EC markets. Under ceteris paribus assumptions importers of manufactures could then pocket terms of trade gains.

The second one partly outweighs the first as it is argued that massive capital inflows into the EC (in order to be protected against protectionism or to participate directly in a growing market) will lead to a real appreciation of the ECU vis-à-vis the dollar and the yen and thus will deteriorate the competitive position of EC suppliers on extra-EC markets [Langhammer, 1989b]
The third one is referred to as "investment diversion". Investment in EC member countries with a similar resource endowment as developing countries (e.g. Portugal and Spain) would become more attractive hosts than non-member developing countries, partly because of the access advantage and partly because of more "structural funds" in favour of the backward areas as a means to subsidise capital formation. While this argument can be defeated in its zero-game meaning (lay-off of investment in LDCs and repatriation to Mediterranean member countries), there is reason to assume that in the short run the relative attractiveness of plant

sites in the Mediterranean member countries versus investment in LDCs could rise. However, again the exchange rate effect would serve as a built-in equaliser since prices of non-tradables in the capital-importing EC member countries would rise relative to prices of tradables (real appreciation) and this would help non-member countries to remain competitive as importers of capital and exporters of goods. Sharply rising labour costs in Spain and Portugal in recent periods bear witness to this argument which receives further support by strong political pressure in old EC member states towards "social harmonisation" and against "social dumping".

## C. The Newly Industrialising Economies and the End of Policy-Induced Market Segmentation in the Community

Compared to the majority of developing countries, the Asian NIEs have to cope with different pre-conditions as far as their net benefits from the internal markets are concerned. To be short, because of their specific export supply and because of their competitive strength market segmentation within the EC was much more important for them than for developing countries. This is indicated by the following characteristics:

(1) NIEs do not export non-competing homogeneous products such as commodities which face the same conditions of market access in individual EC members' markets.

(2) Apart from Japan, Asian NIEs have been the main target of selective protectionist measures under private VERs, surveillance measures, Art 115 EEC Treaty and anti-dumping procedures [see Koopmann, Scharrer paper].

(3) Though being more oriented towards the US market the NIEs took a major share in non-OECD countries manufactured exports to the EC. They enjoyed high ex post income elasticities of EC import demand in the range of 4-5 and will

continue to up-grade their supply in order to sustain such magnitudes.

(4) Should the US increasingly restrict access to its market, the NIEs collective surplus with the Community is expected to rise and this could lead to a harder attitude of the Brussels Commisssion.

(5) Not only Singapore and Hong Kong but also Taiwan and Korea are expected to further advance in some merchandise trade-related services (e.g. maritime shipping) as well as in aviation and engineering services.

To what extent the NIEs will be affected by the internal market apart from the growth and income effects is difficult to answer. Basically, the removal of policy-induced market segmentation in the EC (to be taken separately from natural market segmentation through different consumer preferences) is the main objective of 1992. As a result, information on pre-1992 market segmentation confronting the exports of the Asian NIEs to the Community will allow for some tentative conclusions which, however, are still uncertain as we cannot yet predict past-1992 trade policies in products which are sensitive for individual members.

How important market segmentation in the Community has been in the past for all Latin American and Asian NIEs (Brazil, Mexico and the four Asian NIEs) is documented by the difference in their import market penetration ratios (IMPRs) between the four major EC markets (France, West Germany, Italy, and the UK) in the three major product groups in exports, that is textiles and wearing apparel, electrical machines, and entertainment electronics (Table 1). During 1970 and 1985 the gap widened between West Germany and the UK on the one hand and France and Italy on the other hand. Admittedly, there are differences in per capita income level and market size but they are insufficient to explain widening gaps in import market penetration as France came closer

Table 1 - Import Penetration by NIEs in Selected Products, 1970 and 1985, in per cent of apparent consumption

| OECD countries | Textiles, clothing, leather footwear (ISIC 32) | | Electrical machines appliances (ISIC 383-3832) | | Radio, TV and communication equipment (ISIC 3832) | |
|---|---|---|---|---|---|---|
| | 1970 | 1985 | 1970 | 1985 | 1970 | 1985 |
| US | 1.53 | 11.16 | 0.44 | 5.93 | 1.55 | 7.54 |
| Japan | 1.17 | 3.82 | 0.10 | 0.73 | 0.19 | 0.68 |
| France | 0.11 | 2.08 | 0.01 | 0.73 | 0.06 | 2.39 |
| West Germany | 1.33 | 7.96 | 0.04 | 1.32 | 0.38 | 5.36 |
| Italy | 0.34 | 1.18 | 0.07 | 0.52 | 0.40 | 3.91 |
| UK | 2.10 | 7.74 | 0.14 | 1.15 | 0.37 | 4.11 |

Source: OECD, The Newly Industrialising Countries, Challenge and Opportunities for OECD Countries, (Paris: OECD, 1988), Tables A.2.23-A.2.30.

to West Germany in per capita income and so did Italy with respect to the UK.

This general picture is confirmed if the ratios are disaggregated by individual Asian NIEs and aggregated to total manufacturing (Table 2). The two twin blocs in the Community (West Germany, UK and France, Italy) can be identified for each of the four NIEs, yet, - and this is very interesting with respect to an assessment of effects of reduced market segmentation after 1992 - at very different levels. Interestingly, Hong Kong is the NIE which seems to be most seriously affected by market segmentation. In 1985, Hong Kong had IMPRs of 0.10 and 0.09 in France and Italy, respectively, compared to 0.34 and 0.53 in West Germany and the UK, respectively. On the other side of the scale, there is Singapore with relatively little differences in IMPRs between the four EC member states. Korea is more to the Singaporean end of the scale whereas Taiwan could be ranked closer to Hong Kong. Evidently, differences in the export supply of the four NIEs can partly explain this observation. The Hong Kong as well as the Taiwanese supply seems to be more vulnerable to policy-induced market segmentation, that is to the violation of the customs union principle of free circulation of products within the Community.[1] In the Hong Kong case, the explanation is easy. Hong Kong is the leading textiles and clothing exporter and has to cope with the allocation of MFA quotas in hypersensitive products among the EC member states. As France strictly controls its quota while West Germany does not, market segmentation is evident.

Singapore on the other hand shows the lowest IMPRs of the four NIEs. The country concentrates on electronic components in professional electrical machinery rather than on the sensitive group of pure entertainment electronics. Relatively slow growth of exports to the EC and no "laser-beaming" strategy of targeting

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1 Yet, there is also the possibility that under fairly identical export supplies, the four NICS were treated differently because of their different speed of market penetration.

Table 2 - Import Market Penetration by NIEs for Total Manufacturing in Major OECD Markets, 1970-1985, in per cent of apparent consumption

| OECD Market | NIE | 1970 | 1973 | 1976 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| US | | 0.05 | 0.11 | 0.21 | 0.26 | 0.25 | 0.28 | 0.32 | 0.39 | 0.47 | 0.45 |
| Japan | | 0.08 | 0.27 | 0.31 | 0.33 | 0.26 | 0.27 | 0.29 | 0.27 | 0.32 | 0.30 |
| France | )Korea | 0 | 0.01 | 0.05 | 0.08 | 0.09 | 0.10 | 0.10 | 0.09 | 0.11 | 0.15 |
| W. Germany | | 0.01 | 0.05 | 0.14 | 0.17 | 0.20 | 0.23 | 0.22 | 0.23 | 0.23 | 0.23 |
| UK | | 0 | 0.04 | 0.11 | 0.17 | 0.15 | 0.21 | 0.19 | 0.24 | 0.22 | 0.22 |
| Italy | | 0.01 | 0.02 | 0.04 | 0.08 | 0.11 | 0.09 | 0.08 | 0.07 | 0.08 | 0.09 |
| US | | 0.09 | 0.21 | 0.26 | 0.39 | 0.41 | 0.44 | 0.51 | 0.61 | 0.74 | 0.72 |
| Japan | | 0.08 | 0.19 | 0.19 | 0.25 | 0.20 | 0.20 | 0.22 | 0.21 | 0.25 | 0.24 |
| France | )Taiwan | 0 | 0.02 | 0.04 | 0.08 | 0.09 | 0.11 | 0.11 | 0.11 | 0.13 | 0.13 |
| W. Germany | | 0.06 | 0.11 | 0.16 | 0.19 | 0.24 | 0.26 | 0.24 | 0.27 | 0.30 | 0.28 |
| UK | | 0.01 | 0.08 | 0.09 | 0.14 | 0.15 | 0.19 | 0.19 | 0.25 | 0.29 | 0.27 |
| Italy | | 0.02 | 0.06 | 0.06 | 0.12 | 0.14 | 0.13 | 0.12 | 0.10 | 0.22 | 0.13 |
| US | | 0.14 | 0.16 | 0.20 | 0.25 | 0.27 | 0.29 | 0.31 | 0.34 | 0.41 | 0.36 |
| Japan | | 0.04 | 0.06 | 0.05 | 0.07 | 0.06 | 0.07 | 0.07 | 0.07 | 0.08 | 0.07 |
| France | )Hong Kong | 0.01 | 0.02 | 0.04 | 0.08 | 0.09 | 0.10 | 0.10 | 0.10 | 0.11 | 0.10 |
| W. Germany | | 0.14 | 0.20 | 0.33 | 0.32 | 0.35 | 0.36 | 0.35 | 0.35 | 0.39 | 0.34 |
| UK | | 0.25 | 0.41 | 0.40 | 0.44 | 0.47 | 0.59 | 0.49 | 0.53 | 0.63 | 0.53 |
| Italy | | 0.03 | 0.04 | 0.06 | 0.09 | 0.12 | 0.10 | 0.09 | 0.08 | 0.09 | 0.09 |
| US | | 0.01 | 0.05 | 0.06 | 0.09 | 0.10 | 0.11 | 0.12 | 0.14 | 0.16 | 0.18 |
| Japan | | 0.04 | 0.06 | 0.13 | 0.17 | 0.15 | 0.19 | 0.19 | 0.14 | 0.16 | 0.14 |
| France | )Singapore | 0.01 | 0.03 | 0.04 | 0.06 | 0.07 | 0.07 | 0.08 | 0.08 | 0.07 | 0.08 |
| W. Germany | | 0.01 | 0.04 | 0.06 | 0.08 | 0.10 | 0.09 | 0.09 | 0.11 | 0.12 | 0.11 |
| UK | | 0.05 | 0.10 | 0.07 | 0.09 | 0.09 | 0.11 | 0.10 | 0.14 | 0.22 | 0.18 |
| Italy | | 0.01 | 0.03 | 0.03 | 0.04 | 0.05 | 0.05 | 0.05 | 0.07 | 0.10 | 0.10 |
| US | | 0.49 | 0.84 | 1.07 | 1.42 | 1.50 | 1.61 | 1.73 | 2.07 | 2.56 | 2.41 |
| Japan | 4 Asian | 0.30 | 0.66 | 0.76 | 0.91 | 0.79 | 0.83 | 0.87 | 0.81 | 0.95 | 0.85 |
| France | )NIEs plus | 0.15 | 0.22 | 0.33 | 0.59 | 0.62 | 0.71 | 0.73 | 0.74 | 0.77 | 0.79 |
| W. Germany | Brazil + | 0.38 | 0.60 | 0.91 | 1.02 | 1.15 | 1.23 | 1.24 | 1.23 | 1.49 | 1.40 |
| UK | Mexico | 0.41 | 0.83 | 0.83 | 1.05 | 1.04 | 1.25 | 1.20 | 1.43 | 1.62 | 1.42 |
| Italy | | 0.27 | 0.45 | 0.49 | 0.67 | 0.80 | 0.78 | 0.81 | 0.72 | 0.87 | 0.91 |

Source: As Table 1.

exports to a specific sensitive product group are the two major reasons why Singapore has not been subject to national quota restrictions under Art 115 EEC Treaty during the last few years.

Taiwan on the other hand suffers from an export supply with two product groups vulnerable to market segmentation through national quotas, that is entertainment electronics and clothing including footwear.

Finally, Korea's export profile has become less vulnerable to national quotas since the country succeeded in broadening its export base towards capital equipment (electrical and non-electrical machinery) thus reducing the weight of the sensitive consumer non-durables (see Ji Hong Kim's paper, Table 8).

This does not exclude that Korea's exports do not suffer from EC-wide protectionism. The fact worth mentioning that the 1985 IMPR for Korea was higher in Japan (0.30) than in any of the EC member countries - an observation which cannot be confirmed for the other NIEs - suggests that trade-restrictive measures do matter for Korea. Yet, as the IMPRs for France (0.15) and West Germany (0.23) demonstrate, differences between of the two twin blocs are lower for Korea than for Hong Kong and Taiwan.

Given this ex post pattern of market segmentation, one may be tempted to conclude that the effects of EC 1992 will be noteworthy for Hong Kong and Taiwan and less relevant for Korea and especially Singapore. Yet, cautiousness is at stake. Such a conclusion departs from the status quo assumption that there is no further change in the export supply of the NIEs, and this, of course, is unlikely. Instead, what can be argued is that compared to Hong Kong and Taiwan Korea is a forerunner in shifting its export supply towards products which are less threatened by EC country-specific trade restrictions. If such restrictions would be phased out by 1992, then Korea would experience less changes than, for instance, Hong Kong which after 1992 would try to penetrate deeply into the French clothing and footwear market, for instance. But the uncertainty about "grey" substitutes to national restrictions still exists and suspicion is well-founded that such measures will be taken and will postpone the "true" completion of the internal market. Having said this one should also keep three unknown parameters in mind which are on the supply side. The first one is the future advancement of the Korean automobile and chip industries on the EC market. In view of the importance of these industries the Korean post-1992 export profile with cars and chips could simply not be compared with the pre-1992 profile characterised by consumer non-durables and entertainment electronics. The second unknown parameter is the Korean incentive system itself which may continue to be more domestic market-oriented than until the end-eighties. The third one refers to the role of Japan as a pacemaker having Korea at its heels. Should Japan leave less service-intensive product markets in the EC in which Korea could penetrate and/or should Japan fuel domestic demand, for instance, through the opening of access to land to non-agricultural production, Korea could be a net gainer. In both cases Korea would profit by finding new product markets in the EC <u>and</u> Japan.

After all, those non-EC member countries will profit most from the internal merchandise market which are able to supply service-intensive goods (including marketing, advertising and after-sales service). With common norms and standards (or, alternatively, with mutually recognised norms), the threshold barrier to market entry for service-intensive goods perhaps may decline. Service intensity has characterised the successful Japanese penetration into new EC product markets thus overcoming natural market segmentation. Asian NIEs in general and particularly Korea are best candidates among non-OECD countries to follow this path.

## III. CONCLUDING REMARKS

By the end of 1989, the Community has to cope with a decision and implementation jam both of them augment the risk that the

Internal Market will not be completed on schedule. Major decisions which require unanimity such as tax harmonisation and free movement of people have not been made by the Ministerial Council, nor has the majority of adopted measures been already implemented into national law. Even congenial partners within the Community such as the signatories of the so-called Schengen Treaty on abolishing border controls (Benelux countries, France, West Germany) felt unable to proceed as it was initially intended, that is to end border controls on persons by 1 January 1990 and postponed this date to 1 January 1992.

This situation demands political leadership which is likely to be absorbed by dramatic changes in the political and economic environment of Eastern European countries (EECs). The Community has to respond to demands for aid as well as for measures bringing these countries closer to the Community.

The backlash in the program of the completion of the internal market, however, partly mirrors the failure to complete the custom union.

There is not yet a common position with respect to the remnants of national sovereignty in sensitive merchandise items such as cars, clothing and footwear, not to speak of the impact of liberalising intra-EC trade in services on third countries (e.g. aviation). Additionally, there are new challenges to traditional discriminatory trade policies coming from globalisation of production as the debate on local content rules and so-called "screwdriver" factories witnesses.

Should this be the state of European integration, the Community is at the crossroads. It can give more attention of what happens in Eastern Europe, that is widening co-operation and, ultimately, integration to more countries, and delay the target of 1992. The rationale of this way would be to compare the level of integration and wealth already achieved within the EC-12 with the poor level in the neighbouring Eastern European countries. It is not unlikely that this discrepancy will become politically unsustainable with the opening of Eastern Europe and the claims for launching of aid packages of a Marshall Plan-type.

Alternatively, the Community can try to continue or even accelerate the process of integration deepening among its twelve members in order to be better prepared for this new and unexpected external challenge.

There is much reason to assume that, under the current conditions, the Commission will opt for the second way simply because of its commitments. The Commissioner of Internal Market Affairs of the EC, Martin Bangemann, corroborated this view by stating that until the year 2000 the EC will be not opened for new members. The only exemption is the GDR which merges with the Federal Republic of Germany. The idea put forward by the EC Commission to European non-member states to build a European Economic Space with the EC as first class zone and EFTA together with market oriented COMECON countries forming the second class was not approved by the EFTA members. They demand to be put on a par with EC member states and want to have a say in the decision making process of the EC.

But no matter how the Council of Ministers decides, the external dimension of Europe 1992 will get a new design which is not costless for developing countries and NICs because of several reasons. First, external trade policy can be expected to be redefined towards EECs, e.g. more special and differential treatment, and as unilateral concessions are not open-ended, there might be some burden to be borne by the rest of third countries in terms of preferences foregone. Secondly, under budget constraints, commitments to aid to be conceded to the net losers from Europe 1992 (in particular low-income countries) will compete with aid claimed by the EECs. Thirdly, at least some private investors will find EECs more attractive as hosts than developing countries and NICs provided that political risks are borne by the home country governments (for instance, by guarantees and/or equity participation of parastatals). Given their endowment with human capital, it its very likely that EECs will compete with the NICs rather than with the developing countries for private risk capital.

To summarise, since November 1989 the term European economic integration has broadened in its scope while the external dimension of Europe 1992 may have changed its nature. This adds to the existing amount of uncertainty about forthcoming stages of the internal market and classifies any assessment of the coming three years as guesswork.

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Appendix Table 1 - An Economic Evaluation of the Decisions of the EEC Council on the Realisation of the Commissions Programme for an Internal Market

| No. | Subject | Harmonisation[a] | Purpose of the Proposal: Liberalisation[b] | Mutual Information | Avoidance of negative Externalities |
|---|---|---|---|---|---|
| | I. Removal of physical barriers | | | | |
| 1 | Simplification of Community transit procedure | | x | | |
| 2 | Duty free admission of fuel contained in the fuel tanks of commercial motor vehicles | | x | | |
| 3 | Single administrative document | x | | | |
| 4 | Abolition of customs presentation charges | | x | | |
| 5 | Elimination of customs formalities in the framework of the TIR Convertion | | x | | |
| 6 | Abolition of border controlling measures for commercial motor vehicles and inland navigation | | x | | |
| 7 | Abolition of th presentation of border crossing documents | | x | | |
| 8 | Pilotprogramme for the control of hydrophopia | x | | | |
| 9 | Final eradication of brucellosis, tuberculosis and leukosis | x | | | |
| 10 | Live animals of porcine species: Eradicication of African swine fever in Portugal | x | | | |
| 11 | Live animal of the porcine species: Eradication of African swine fever in Spain | x | | | |
| 12 | Eradication of classical swine fever | x | | | |
| 13 | Production and trade in milk | x | | | |
| 14 | Hormon growth promoters | x | | | |
| 15 | Microbiological controls | x | | | |
| 16 | Medical examination of personnel | x | | | |
| 17 | Minced meat and similar products: Health Problems | x | | | |

| No. | Subject | Purpose of the Proposal<br>Harmonisation[a] | Liberalisation[b] | Mutual Information | Avoidance of negative Externalities |
|---|---|---|---|---|---|
| 18 | Antibiotic residues | x | | | |
| 19 | Control of residues | x | | | |
| 20 | Acceptance for breeding purposes of purebred breeding animals of the bovine species | x | | | |
| 21 | Zootechnical standards porcine species | x | | | |
| 22 | Swine fever | x | | | |
| 23 | Control of foot and mouth disease | x | | | |
| 24 | Semen of animals - bovine species | x | | | |
| 25 | Food for particular nutritional uses | x | | | |
| 26 | Modification of Directive 77/89 - meat products | x | | | |
| 27 | Amendment to Directive 80/215 on animal health problems affecting intra-community trade in meat products | | x | | |
| 28 | Amendment to Directive 64/433 on health problems affecting intra community trade in fresh meat | | x | | |
| 29 | Amendment of Directive 72/462 on health and veterinary inspection problems upon importation from third countries | | x | | |
| 30 | Amendment of Directive 77/93 (plant health) | | x | | |
| 31 | Proposal for Directive on the fixing of guidelines for the evaluation of additives used in animal foodstuffs | x | | | |
| 32 | Amendment of Directive 77/93 Plant protection controls | x | | | |
| 33 | Maximum levels for pesticide residues in cereals and food stuffs of animal origin | x | | | |
| 34 | Amendment of Directive 79/117/EEC on the prohibition of certain plant protection products | x | | | |
| 35 | Certification of seeds | x | | | |
| 36 | Pleuro-pneumonia in Portugal - financial scheme for eradication | x | | | |

| No. | Subject | Purpose of the Proposal<br>Harmonisation[a] | Liberalisation[b] | Mutual Information | Avoidance of negative Externalities |
|---|---|---|---|---|---|
| 37 | Imports of meat products from third countries | x | | | |
| 38 | Pedigree animals - sheep and goats | x | | | |
| 39 | Harmful organism in seeds and seed potatoes | x | | | |
| 40 | Hygienic problems with the production and distribution of egg products | x | | | |
| 41 | Embryos of animals | x | | | |
| 42 | Mutual asistance and cooperation of national administrations and the Commission for the proper adaption of veterinary prescriptions | | | x | |
| 43 | Veterinary controls of intra-EC trade | x | | | |
| 44 | Mixed feed stuff | x | | | |
| 45 | Sixth Directive relative to allowance in intra-Cummunity travel: increase to 350 ECU | | x | | |
| 46 | Tax reliefs to be allowed on the importation of goods in small consignments of a non-commercial character up to 110 ECU | | x | | |
| 47 | Small consignments: tax reliefs to be allowed on the final importation of goods | | x | | |
| 48 | Modification of Directive 83/183<br>Tax relief to be allowed on the final importation of goods for personal use by individuals from member states | | x | | |
| | II. Removal of technical barriers | | | | |
| 49 | Extension of information procedures on standards and technical rules | | | x | |
| 50 | Simple pressure vessels | x | | | |

| No. | Subject | Purpose of the Proposal: Harmonisation[a] | Liberalisation[b] | Mutual Information | Avoidance of negative Externalities |
|---|---|---|---|---|---|
| 51 | Electromagnetic compatibility | x | | | |
| 52 | Safety of toys | x | | | |
| 53 | Machinery equipment | x | | | |
| 54 | Personal safety equipment | x | | | |
| 55 | Motorcycle replacement exhaust systems | x | | | |
| 56 | Motor vehicles - lateral protection | x | | | |
| 57 | Gaseous emission of motor vehicles' engines | x | | | |
| 58 | Gaseous emission of Diesel engines | x | | | |
| 59 | Diesel particulates | x | | | |
| 60 | Type approval of motor vehicles and their trailers | x | | | |
| 61 | Modification of Directive 70/220 Threshold values for motorvehicles with a cylinder capacity up to 1.4 ltr. | x | | | |
| 62 | Certain parts and peculiarities of radar driven tractors | x | | | |
| 63 | Rollover protection structures on tractors | x | | | |
| 64 | Modification of Framework Directive 74/150 | x | | | |
| 65 | Food additive | x | | | |
| 66 | Materials in contact with foodstuffs | x | | | |
| 67 | General Directive on sampling and methods of analyses | x | | | |
| 68 | Frozen foods | x | | | |
| 69 | Flavourings | x | | | |
| 70 | Extraction solvents | x | | | |
| 71 | Preservatives | x | | | |
| 72 | Emulsifiers | x | | | |
| 73 | Coffee extracts, chicory | x | | | |
| 74 | Obligation to indicate ingredients and alcoholic strength | | | x | |
| 75 | Stimulants (plastic materials in contact with foodstuffs) | x | | | |

| No. | Subject | Purpose of the Proposal | | | |
|---|---|---|---|---|---|
| | | Harmonisation[a] | Liberalisation[b] | Mutual Information | Avoidance of negative Externalities |
| 76 | Indication of prices of foodstuffs | | | x | |
| 77 | Jams | x | | | |
| 78 | Placing on the market of high technology medical products | x | | | |
| 79 | Proposal amending Directive 75/318/EEC concerning the testing of medical specialities | x | | | |
| 80 | Directive 81/852/EEC concerning veterinary medical products | x | | | |
| 81 | Proposal for a Council recommendation concerning tests relating to the placing on the market of medical specialities | x | | | |
| 82 | Proposal for a Council Directive amending Dir. 66/65/EEC concerning medical specialities | x | | | |
| 83 | Price transparency in the prices of medicines and social refund | | | x | |
| 84 | Membership of the European Pharmacopeia | - | - | - | - |
| 85 | Directive relating to Restrictions on the marketing and use of PCB`s | | | | x |
| 86 | Directive relating to "Restrictions on the marketing and use of asbestos" | x | | | |
| 87 | Non-ionic detergents | | | | x |
| 88 | Classification, packaging and labelling of dangerous preparations | | | x | |
| 89 | Membership of the European Agreements on detergents | - | - | - | - |
| 90 | Liquid fertilisers | | | x | |
| 91 | Construction products | x | | | |
| 92 | Tower cranes: permissible sound levels | x | | | |
| 93 | Household appliances: airborn noise | x | | | |
| 94 | Type pressure gauge | x | | | |
| 95 | Hydraulic diggers (noise) | x | | | |

| No. | Subject | Harmonisation[a] | Purpose of the Proposal: Liberalisation[b] | Mutual Information | Avoidance of negative Externalities |
|---|---|---|---|---|---|
| 96 | Protection of hotels against fire | x | | | |
| 97 | Indication of prices of non-foodstuffs | | | x | |
| 98 | Cosmetics | | | x | |
| 99 | Directive on products which, appearing to be other than they are, endanger the health or safety of consumers | x | | | |
| 100 | Good laboratory practices: non clinical testing of chemicals | | | x | |
| 101 | Modification to Directive 84/538 on lawn mower noise | x | | | |
| 102 | Food surveillance | x | | | |
| 103 | Fruit-juice and products of the same kind (third modification of directive 72/726) | x | | | |
| 104 | Labelling of foods and advertising (Modification of directive 79/112 | x | | | |
| 105 | Trace elements in fertilizers | x | | | |
| 106 | Definition of spirituous beverages and aromatised wines | | | x | |
| 107 | Extension of directives to medicinal products not already included | x | | | |
| 108 | Secundary fertilisers | x | | | |
| 109 | Modification of directive 71/305 (Procedures for building contracts) | | x | | |
| 110 | Public procurement; procedures for verification | | x | | |
| 111 | Public supply contracts (directive 77/62 and directive 80/767) | | x | | |
| 112 | Comparability of vocational training qualifications | | | x | |
| 113 | University/Industry Cooperation in the field of new technologies | x | | | |
| 114 | Coordination relating to commercial agents | x | | | |

| No. | Subject | Harmonisation[a] | Purpose of the Proposal<br>Liberalisation[b] | Mutual Information | Avoidance of negative Externalities |
|---|---|---|---|---|---|
| 115 | Coordination of provisions in respect of certain activities in the field of pharmacy | x | | | |
| 116 | Mutual recognition of diplomas in pharmacy | | | x | |
| 117 | Specific training in general medical practice | x | | | |
| 118 | Regulated professions: Mutual recognition of higher education diplomas | | | x | |
| 119 | Annual accounts of banks | x | | | |
| 120 | Capital resources-banks | x | | | |
| 121 | Foreign accounts: banks | x | | | |
| 122 | Prospectus to be published when securities offered | x | | | |
| 123 | Activity of credit bank and modification of the second banking directive | x | | | |
| 124 | Solvability ratios for credit banks recommendation on the setting up of a guarantee system of deposit within the Community | x | | | |
| 125 | Coordination of regulations regarding insider trade | x | | | |
| 126 | Non-life insurance | | x | | |
| 127 | Coordination of laws relating to legal expenses insurance | x | | | |
| 128 | Credit insurance | x | | | |
| 129 | Collective investment undertaking for transferable securities | x | | | |
| 130 | CITS Directive: special measures concerning certain investments | x | | | |
| 131 | Information to be published when major holdings are acquired or disposed of | | | x | |

| No. | Subject | Harmonisation[a] | Purpose of the Proposal<br>Liberalisation[b] | Mutual Information | Avoidance of negative Externalities |
|---|---|---|---|---|---|
| 132 | Fares for scheduled air services | x | | | |
| 133 | Air transport: sharing of passenger capacity and market access | x | | | |
| 134 | Air transport: application of Articles 85 and 86 | | x | | |
| 135 | Road transport: Community quota | x | | | |
| 136 | Road transport-freedom to provide services in the transport of goods | | x | | |
| 137 | Maritime transport: freedom to provide services in the sea transport sector: Application of Art. 85 and 86 of Rome treaty to maritime transport; Maritime transport: unfair pricing practices; Maritime transport: Coordinated action to safeguard free access to cargoes in oceanic trade | x | | | |
| 138 | Pan European mobile telephones | x | | | |
| 139 | Establishment of a common policy for the development of an information services market | x | | | |
| 140 | Exercise of television activities - Recommendation on a European Code of Conduct relating to electronic payment - | | | x | |
| 141 | Liberalisation of units in collective Investment undertaking for transferable securities | | x | | |
| 142 | Liberalisation of operations such as transactions in securities not dealt in on a stock exchange | | x | | |
| 143 | Liberalisation of capital movements | | x | | |
| 144 | Proposals for a Regulation for a European Economic interest grouping | x | | | |
| 145 | Directive in the area of company law | x | | | |
| 146 | Trademarks: first directive | x | | | |
| 147 | Legal protection of micro circuits | x | | | |

| No. | Subject | Purpose of the Proposal: Harmonisation[a] | Liberalisation[b] | Mutual Information | Avoidance of negative Externalities |
|---|---|---|---|---|---|
| | III. Removal of fiscal barriers | | | | |
| 148 | 13th VAT Directive concerning tax refunds to persons not established in the community | x | | | |
| 149 | 17th VAT Directive concerning the temporary importation of goods other than means of transport | x | | | |
| 150 | Harmonisation of the structure of excise duty on alcoholic drinks | x | | | |
| 151 | 18th VAT Directive - Modification of certain exemptions provided by the directive 77/388 | x | | | |

[a] Approximation of law regulations, administrative actions and norms of member states by agreement.

[b] Opening of market access.

Source: Fourth Progress Report of the Commission to the Council and the European Parliament concerning the Implementation of the Commission's White Paper on the Completion of the Internal Market. Documents, COM (89) 311 final. Luxembourg June 20, 1989.