THE IMPACT OF EC-92 ON TRADE IN DEVELOPING COUNTRIES

A. J. Hughes Hallett

How is the attempt of the European Community (EC) to create a single market going to affect the developing countries? This article argues that the net direct effects of EC-92 may be rather small: the trade creation and trade diversion effects brought about by the program may cancel each other out, with few repercussions for the developing countries as a group. The expected changes in trade flows arising from relatively small changes in nominal prices and aggregate incomes, the changes in market structure, the removal of internal barriers, and a predicted 5 percent increase in EC output may be important to European policymakers, but they are rather remote from the developing countries.

The threat of EC-92 to the developing countries lies elsewhere: from diversion of investment from those countries to the EC and from the resurrection of protectionism by the EC, especially in the form of nontariff barriers, toward the outside world.

“We are not building a single Market in order to turn it over to hungry foreigners.” (Willy de Clerq, while Commissioner for Foreign Relations in the EC, quoted in Hamilton 1991.)

The principal goal of the EC-92 program is free trade among the member countries of the European Community. For the developing countries, the question is whether the reforms will have a correspondingly liberalizing effect on trade between the EC and the rest of the world—or whether they will more likely become bastions of a newly protectionist “Fortress Europe.” The rhetoric of European policymakers (of which de Clerq’s remark quoted above gives a flavor) is not reassuring. Far from bringing the promise of reform, trading arrangements such as the EC’s 1992 program have lowered expectations of what the current talks to revise and extend the General Agreement on Tariffs and Trade (GATT) might achieve. And the recent breakdown of the GATT talks has reinforced fears that the liberal multilateral trading system, built up since World War II, was degenerating into a system of regional...
trading blocs practicing a new form of protectionism characterized by multi-
lateral, rather than unilateral, restrictions and by nontariff barriers, such as
technical and environmental standards. These new trading arrangements may
have profound implications for the developing countries.

The prospect of East Asian and North American trading blocs with an in-
terest in undermining the GATT's free trade objectives seems unlikely (see
Schott 1991).1 The prospective East Asian bloc is too dispersed and diverse in
income levels and market structures; its external trade outweighs its internal
trade by two to one and remains very dependent on access to U.S. markets.
The proposed North American bloc is more cohesive economically, but its ex-
ternal trade is one and a half times the internal trade, and each member needs
to cure a persistent current-account deficit; the bloc consequently needs to ex-
pand its exports to the rest of the world. Both blocs thus have an incentive to
support the GATT trading rights and discipline.

The EC, by contrast, is relatively cohesive as a trading bloc (table 1), and
the logic of its EC-92 program suggests that greater barriers will be needed
against the rest of the world to ensure success on the scale foreseen. It therefore
makes sense to look at the EC single market initiative as the source of change
and a possible threat to production and trade in the developing countries. For

Table 1. Export Markets of the Emerging Trading Blocs
(billions of U.S. dollars)

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<td>298</td>
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**Note:** EC member countries are Belgium, Denmark, France, Germany, Great Britain, Greece, the Republic of Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain. The North American bloc consists of Canada, Mexico, and the United States. The East Asian bloc includes Australia, Hong Kong, Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, the Philippines, Singapore, Taiwan (China), and Thailand.

**Source:** Schott (1991).
those countries, the question is twofold: will the reforms in and of themselves have sizable repercussions, either for better or worse; and will Europe’s commercial policies prove protectionist, and hence damaging, in effect rather than in word?

General Implications of the Proposed Reforms

Completing the internal market in Europe entails removing all the barriers to trade between member countries of the EC. That nearly 300 separate directives are needed to secure the free movement of goods, services, and factors of production indicates how fragmented the existing market is. Indeed, differing national controls and restraints (especially on capital, labor, and services) and differing health and safety standards were making that market even more fragmented. Many of the changes are directed at improving market access for EC participants; some are intended to make markets function more flexibly (to improve competitiveness, set standards, or establish pollution controls); and some are to promote competition or to exploit comparative advantage or economies of scale.

The Development of Prices and Incomes

Analysts broadly agree that EC-92 will bring benefits to EC countries; they agree less about the size of the benefits and how they will be distributed across the EC. There is even less agreement—indeed, there is very little analysis—on how strong the effects will be on economies outside the EC, or even whether the net effects will be positive or negative.

In general terms, the EC countries can expect higher income levels and lower prices as internal barriers to trade come down. Increased competition, greater efficiency through economies of scale and the wider scope for investing according to comparative advantage, the removal of internal customs duties and other transactions costs, the removal of price discrimination, competitive tendering for government contracts, free circulation of goods from the cheapest supplier, and a lower cost of capital through more efficient (integrated) financial markets—all these will reduce prices within the EC. Falling prices will in turn expand EC markets and consequently raise income levels in real as well as nominal terms. This should have a continuing effect through increased investment, both internally and from outside the EC, if foreign investors are tempted to establish a base within the union.

Some effects may, however, offset these nominal price falls and income gains. If health and safety standards or pollution controls are tightened to match the most stringent within the EC, then industry’s costs must rise. Similarly, if external barriers (tariffs, quotas, or voluntary restraints) increase while the internal barriers are being dismantled, then cheaper external suppliers will
be shut out and prices will rise. Firms might also collude to overcome competitive pressures, a practice that the EC Commission might condone to gain support for its program. Indeed this has already happened in activities such as air transport, car production, electronics, banking, and food production. Aggressive reciprocity or discriminatory standards could exclude non-EC imports. But these counter-effects are generally expected to be insignificant.

The key questions are then: how much will prices fall and incomes rise, and what are the repercussions for the non-EC economies? The empirical evidence on the first question is slight and conflicting, except that the gains in EC variables are likely to be fairly small. Optimistic estimates from the Cecchini report (Cecchini 1988; European Economic Community 1988a, 1988b) suggest 1 percent added to gross national product (GNP) for each of five years and a 0.5 percent improvement in the EC's terms of trade. The spillovers onto countries outside the EC could be quite large, however, if they are smaller economies dependent on EC trade—such as the ex-colonial countries of the Lomé Convention² or the countries of East Europe.

Trade Creation and Trade Diversion

The two factors that will determine the spillover effects are the proportion of EC trade conducted with third countries (currently just over 40 percent, ranging from 52 percent for the United Kingdom and Denmark to 25 percent for the Netherlands) and the share of exports in the third country's gross domestic product (GDP). The relevant parameters will therefore be the price and income elasticities of third country exports, since these determine the amount of trade diversion (exports lost as EC prices fall with increasing competitiveness), and the amount of trade creation (exports gained as EC incomes rise with market expansion and efficiency). The balance between these two effects will largely determine whether the trade spillovers are positive or negative overall. A terms-of-trade effect may also occur as the prices of EC exports fall and EC penetration into foreign markets rises. In that case, price elasticities of imports in non-EC countries may also play a role. Indeed, there may be offsetting price and income effects in the third country as the domestic price index falls with import prices and export industries expand toward greater economies of scale, so that incomes may start to rise there too. But these would be second-order effects. Finally, the spillover effects may be complicated if EC-92 reduces market access, tightens local content requirements, or raises other trade barriers for non-EC producers.

Investment Diversion

That is not the end of the spillover story, however, because investment expenditures are likely to rise in the EC. The repercussions elsewhere will depend
on the extent of investment creation versus investment diversion. If the net effects on trade are positive—that is, if more trade is created than diverted—then some new investment will be induced in third countries to supply that trade. But if the net trade effects are negative, or if local investment funds originate in either the EC or other industrial countries that wish to invest in the post-1992 EC, then investment will be diverted from third countries. Whether there is much investment diversion depends on the elasticity of savings in the industrial countries. If they are highly elastic, savings will rise while interest rates remain constant—leading to investment creation as the rate of return on the marginal investment project is not increased. But if they are inelastic, total investment will remain constant, and the rate of interest will rise as investment in third countries is displaced to make room for projects in the EC with higher rates of return. In fact private consumption and savings, largely financed from current income according to a life-cycle pattern, are unlikely to be affected by changes in financial conditions. So, unless EC-92 increases taxes and hence public savings, we must conclude that savings will not respond to the changing investment opportunities in Europe and that the developing countries are likely to suffer some investment diversion and loss in technology transfers.

It is possible, however, that some investment in labor-intensive activities, or in cheaper but environmentally unhealthy technologies, will be diverted to the developing countries as economies of scale and tighter regulation take hold in the EC. Moreover, investment diversion has dynamic implications because, once low labor costs are weakened as an incentive to investment, productivity and technical capacity in developing countries will fall further behind—reducing their competitiveness and their ability to attract new investment. Falling investment means falling expenditures and a lower supply capacity later on. These effects may be more important for Latin America and Southeast and East Asia, both because they have been the principal recipients of foreign investment and because they have manufacturing industries that are large and sophisticated enough to compete with EC firms for investment funds.

The Influence of Commercial Policy

Two distinctions are important here: first, between the consequences of removing barriers that operate on prices or costs versus the consequences of removing barriers that operate on quantities; and, second, between the case where the internal trade barriers only are reduced and where they are reduced for the EC’s external trade as well.

Examples of barriers that operate on prices are import duties; price discrimination, market segmentation, local cartels, or discrimination in government contracts; transactions costs; extra testing formalities; and barriers to economies of scale or comparative advantage in production. Capital market imperfections, currency transactions costs, risk premia, or inadequate financial market access would have the same effect on investment.
Examples of quantity barriers are import quotas, voluntary trade restrictions, purchasing agreements, local content requirements or other restrictions that prevent economies of scale from being realized, and environmental controls. And barriers to investment include capital controls or ownership “cartels” that block a free market in corporate control. In fact, most of the EC-92 measures, whether they operate on prices or quantities, are designed to improve market access and the competitiveness of EC firms—through increased mobility of labor and capital, the free internal circulation of goods, and larger expenditures on research and development.

These measures will have different effects on EC and non-EC firms, so they must potentially cause trade to be diverted rather than created. Meanwhile, a reduction in external barriers (such as quotas, voluntary restraints, common external tariffs, and standards) would result only in trade creation. But it is not clear that these external barriers will actually be reduced. Standards may be harmonized at the highest level, quotas and tariffs may be maintained to allow the internal changes a smoother passage, and price supports (above world prices) on such fundamentals as agricultural products, coal, and steel, which already operate on an EC-wide basis, are unlikely to change much. So it is not clear how much trade will be created.

THE EFFECTS IN PERFECTLY COMPETITIVE MARKETS. The traditional analysis of trade creation versus trade diversion assumes perfect competition and segmented markets (that is, no spillovers between markets). Together, those assumptions imply that prices equal marginal costs and that no other markets gain from spillovers after the internal barriers are removed. The increase in competitiveness would then equal the sum of the barriers removed—for the EC, that is said to total about 1 to 2 percent of the value of the EC’s internal trade (Winters 1991).

Certain markets offer greater scope than that because they are not competitive or because prices are fixed by intervention: for example, agriculture, coal, steel, textiles, and certain high-tech manufacturing. Although there is obvious scope for reorienting and increasing trade in these markets, it is reasonable to assume that the EC’s intervention schemes will not be dismantled. Certainly, that has been the impression left by the Uruguay Round of the GATT negotiations. That would certainly moderate the scope for greater gains. At the same time, the existence of spillovers between markets would change the results since the effect of lower prices in one market is to produce cheaper inputs in others. However, where there are capacity constraints, the consequent rise in demand (in either factor or product markets) may produce price rises that offset the cost reductions. So, once again, we should probably not expect too much in overall gains.

THE EFFECTS OF INVESTMENT DIVERSION. There is already evidence that investment flows have been influenced both by accelerator effects based on growth
expectations and by a lower cost of capital. Stronger influences are probably the desire to invest where comparative advantage or scale economies are (as yet) unexploited or to establish plants that can satisfy local content restrictions.

How large is the investment diversion likely to be? Imagine two firms before EC-92, each with its own national tariff. After EC-92, the more efficient of the two will capture the market, and the other will vanish. The more efficient firm will either match world prices or need an EC-wide tariff; had it been capable of matching world prices before, it would have done so and would have expanded to its optimal size by exporting what could not be sold domestically (Corden 1972). Hence, there are limits to the EC-92 gains: investment designed to capture economies of scale or comparative advantage can reduce costs only to the extent of the pre-1992 barriers. Had the potential been greater, it would have been exploited earlier. The EC’s import competing firms are therefore unlikely suddenly to become exporting firms. That limits trade diversion to eliminating the EC’s existing imports—and probably rather less than that. If the loss in intra-EC trade from internal barriers is 1 to 2 percent of the gross value of that trade, the extent to which new investment can divert trade in those markets is still only 1 to 2 percent. That may not seem a great deal; but for a developing country or East European economy dependent on a few export markets, it may represent a substantial loss in exactly those sectors that are crucial for development and growth. And to that we must add the possibility of changes in aggregate supply: greater efficiency brings EC firms closer to the optimal production size (Muller and Owen 1985). Average industry costs will then fall, expanding the size of the market—but putting yet further pressure on the external producers.

The effects in imperfectly competitive markets. The possibilities for re-orienting trade in imperfectly competitive markets are much larger. Here, the less efficient firms in one EC market may find that their domestic market share shrinks as lower-cost producers elsewhere in the EC move in. Such firms would get smaller or vanish. Conversely, the opening of other EC markets might allow these firms to expand toward greater economies of scale in a way that was previously blocked by the fragmented nature of the market and the pre-1992 trade barriers. In that case EC-92 would enable them to survive in the EC and to capture more of the third countries’ markets through their increased competitiveness in relation to the rest of the world (Smith and Venables 1988). Thus, in imperfectly competitive markets, the developing countries may have something significant to worry about: EC firms may not only displace third country producers from EC markets but also start exporting into the corresponding third country markets. For them, the costs of EC-92 would be trade diversion beyond the 1 to 2 percent postulated for perfectly competitive markets and may even include trade reversals (Norman 1989).

In fact EC-92 may not have any strong pro-competitive effects. For one thing, the existence of fixed costs means that, as prices fall with lower barriers
and increased competition, the number of firms will start to fall. But there is no reason to expect the number of non-EC suppliers to increase. Consequently, a smaller number of EC suppliers will tend to reinforce imperfect competition, reviving profit margins while reducing costs through greater economies of scale. Indeed, models of oligopoly relate markups positively to market share. Thus, if EC producers gain a larger share of their home (and, hence, world) markets, EC export prices may rise—which, if import prices are falling, would leave the non-EC economies with worsening terms of trade.

Another factor is that EC-92 can lead to less market segmentation in the EC, so the procompetitive spillovers from one market to another will be larger than before. That will multiply the instances of falling prices and costs in the EC and, hence, of trade diversion. However, these outcomes assume an elastic supply of the factors of production in the EC. If firms run into supply constraints, such as insufficient mobility of labor, costs will start to rise faster, offsetting some of the pressure for trade diversion.

**EC Trade Policy: The GATT as a Cooperative Game**

The impact of EC-92 on non-EC economies will obviously be affected by changes in EC trade policy, although what those changes will be is an open question. For example, will a system of EC-wide quotas replace national import quotas? If it does and the level of the lowest quota is chosen, trade with non-EC partners will be encouraged; if the level of the highest is chosen, trade will be suppressed. But, even with an unchanged average level of quotas, the volume of trade with non-EC countries will change because, without Article 115 of the Treaty of Rome (which limits the movement of restricted goods among member countries), trade will automatically be redirected. If the more restricted markets are in the larger economies, then trade will expand. But if they are in the smaller economies, it will contract. Nor can the use of antidumping policies, discriminatory standards, and voluntary restraints or the aggressive use of reciprocity and tighter rules of origin be ruled out. All such policy responses would worsen the position of the developing economies.

So what trade policy should we expect after 1992—Fortress Europe or a more open EC? No clear pronouncements have been made; the stalled GATT negotiations provide no pointers, and the European Commission has no manifesto or established ideology to guide us.

The only indicators of what might happen are the interests of the EC’s constituency and the EC’s track record. That takes us into the realm of political economy and, as Wolf (1987) points out, makes greater protectionism look more likely. Wolf argues that the GATT’s fragility, each country’s veto on sanctions, and the lack of self-enforcing controls have allowed regional integration (and the EC’s policy in particular) to weaken the whole arrangement. That has happened because of the EC’s increasing use of trade policy as an instrument for satisfying special interests.
Recent research has focused on the role of special interest groups in strengthening any tendency to protectionism. Grossman and Helpman (1993), for example, show that the interaction between the granting of political support and economic performance will lead governments to develop higher import tariffs or export subsidies than they would have done in the absence of political interaction from special interest groups. Explicit cooperation between those governments weakens that result, however. Thus the EC, as a coalition with its own pressure groups within the GATT, would be increasingly protectionist—even if less protectionist than its members might have been if left to themselves. Certainly the EC's performance over agricultural policy in the Uruguay Round is consistent with that conclusion. De Melo and others (1992) have the same result with a different slant. Forming a coalition dilutes the impact of special interest groups and therefore the latent protectionism, but only if there is symmetry of preferences. With sufficient asymmetry the dilution effect will be more than offset, and the larger the number of countries in the coalition the more likely is that to happen. Once again one would expect the EC as a coalition in the GATT to be more protectionist, unless the degree of convergence in preferences in the EC were significantly larger than that within the GATT as a whole.

Wolf argues that the postwar trading system has been a cooperative regime in which there is no advantage in unilateral liberalization—but there are advantages (for all) in multilateral liberalization so long as all "play the game." The threat of discrimination against those who broke ranks, in particular denial of access to the large U.S. market, sustained this process of liberalization for many years. But, as in all cooperative regimes, there is often little sanction against individuals who revert to their best noncooperative policies—and quite possibly none at all against those who form a coalition against the rest. First, participants may judge retaliation to be uncertain, unreliable, and costly for the injured party. Second, countries may be reluctant to incur the costs of retaliating against dissidents whose unilateral actions do not affect them much. Similarly, those who would be affected will be reluctant to afford trade benefits to those who, by putting private interests ahead of the gains from cooperation, fail to play the game. It is preferable to try to lock one's immediate trading partners into a policy of liberalization and market access by creating a mini-GATT, which has the credible threat of expulsion and loss of market access, and ignore the rest, than to attempt a looser or less effective arrangement to encompass the more remote trading partners. That in itself would start to produce coalition groupings, and, once two or more larger "players" are operating, the pressure for freer trade would fade, because the competitive offering of access to the coalitions' markets would secure much of the cooperative gains for the coalition members, while reciprocal discriminatory trade policies would ensure that free trade in a wider sense is always denied to some group(s). Indeed, it might be possible to form a coalition that was able to secure greater benefits for its members than would have been enjoyed under full cooperation.
The cost would be worse outcomes for those outside—who might then form a coalition in self-defense.

From this perspective, the EC is just such a coalition, with North America and East Asia as its rivals. On that basis, one should expect the EC to follow protectionist policies with respect to nonmembers. The EC has been reluctant to extend most-favored-nation status to competitors in certain fields (for instance, to East European or East Asian economies); it has kept its preference areas (such as the Lomé Convention countries and the general system of preferences); and it has used commercial policy to further its special interests and the process of economic integration. Once again, one would have to conclude that the EC is likely to become more, rather than less, protectionist. But exactly what form that protectionism might take is difficult to predict because each measure has different effects on the EC members, damaging some as it helps others.

As a result, EC trade restrictions are not systematic but reflect a patchwork of improvised deals. This may explain, in part, why the GATT negotiations have stalled in the face of an apparently intransigent EC position, even though recent developments may signal some softening. It may also explain why the EC is able to maintain a position ostensibly consistent with the GATT while imposing restrictions that in practice are more protectionist. The standard instruments (outside agriculture) are tariffs (the GATT's main concern), quotas, voluntary export restraints, and nontariff barriers covering health, technical standards, or environmental protection. The EC now uses tariffs very infrequently, having removed most of them since World War II. It has also been reluctant to impose nontariff barriers except in specific industries where it can differentiate the product in a technical sense (Greenaway 1992; Wolf 1987). General restrictions of this type damage most member states while helping only specific states or industries. It is far easier to use quotas and antidumping or export restraints that can be targeted rather precisely and are otherwise invisible. Perhaps more important, the effects of nontariff barriers on taxation, redistribution (or subsidies), and rent transfers are largely invisible both inside and outside the EC.3

Reducing the general barriers, while maintaining and possibly increasing particular nontariff barriers, therefore allows the EC to retain policies which are consistent with the rhetoric of the GATT, while achieving rather different effects in practice. Not that such a strategy is in any way unfair, but it does make it extremely difficult to tell whether the EC's policies are actually consistent with the GATT or not.

What the Developing Countries Might Fear

Which of the preceding arguments matter for the developing countries? Until recently their concern about EC-92 was muted, and it is easy to see why. The overall effects of EC-92 on Europe seem likely to be limited and the consequences for developing economics correspondingly small. And because develop-
oping countries are usually seen as suppliers of inputs, rather than of competing products, any gains in the EC should spill over onto them.

Several areas, however, have emerged where the developing countries could encounter significant difficulties. First, nearly all the analysis on the subject (and the EC Commission’s own evaluation [Cecchini 1988] in particular, has focused on trade in goods, whereas one of the main effects is likely to be investment diversion. Economic development in the developing countries is particularly sensitive to foreign capital and investment.

Second, what is small to the EC may be very important to the developing countries. Here, the EC’s rhetoric is important. In sixteen volumes of studies of the EC-92 program, the EC Commission made scarcely any references to the rest of the world. And then there are the statements such as de Clerq’s about restricting outsiders’ access to any benefits. The developing countries are also painfully aware that for every ECU (European currency unit) spent on aid, roughly two ECUs are spent on restrictions to keep their exports out.4

Third, developing countries are not exclusively commodity producers; trade has switched substantially to manufactures, especially in Latin America and the newly industrialized economies (NIES) or near-NIES of Asia. Their manufactures are competitive with EC products and therefore subject to trade diversion, which might well outweigh any trade creation.

Fourth, the developing countries have already seen how increasing protectionism can damage their prospects, not only in agriculture and food products, where liberalization is no nearer, but also in textiles, steel, and light manufacturing. The EC’s stubbornness in the Uruguay Round, and the fact that East Europe was able to secure concessions on debt, which were denied to the developing countries, also suggest that the developing countries should not expect greater market access to help offset any trade diversion that may occur.

Evidently the consequences of EC-92 will be specific to countries or groups of countries. We need to distinguish manufacturing economies from commodity producers and distinguish countries by such characteristics as their dependence on foreign capital, trade in services, or receipts from migrant labor.

**Trade in Manufactured Goods**

The removal of national barriers will create and divert trade only if no new EC barriers are introduced to replace them. But new restraints are likely (Silbertson 1989), partly to satisfy the special interests that pressed for the original restraints and partly because the EC sees no reason why foreign producers should benefit as much as EC producers. The barriers that, if retained, would be important to developing countries’ producers are those on textiles—the Multifibre Arrangement (MFA)—clothing, footwear, light manufactures, consumer electronics, cars, and agricultural commodities. Indeed external barriers already exist for cars. Pressure from French and Italian car firms has led to an EC-wide restraint on Japanese cars that could easily be extended to Korean or

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Malaysian cars. The significance of this should not be underestimated; cars represent a symbolically and economically important sector, and the Commission might find it convenient to allow such restrictions in other sectors because that gives the Commission greater control over trade policy.

The argument that such arrangements would be transitional is not compelling. That argument was used to introduce the Short-Term Arrangement on Cotton Textiles in 1961 and subsequently extend it into the MFA. Thirty years later these restraints still exist. The source quotas here are maintained by Article 115, but that could easily be replaced by an EC-wide restraint. And there is pressure for some kind of transitional arrangement for clothing, especially from the southern European producers who have gained significantly from trade diversion. Although just one or two developing countries would be affected by trade restraints on cars, a wide range of developing countries would be losers if restraints continued on textiles and clothing.

Trade in Services

Services is a large sector (about 50 percent of GDP in the developing countries and more than that in the EC), so EC-92 could have a strong impact in that sector. But most of the output is not tradable, so few of the changes would spill over to the developing countries. The three components that will become more widely tradable after EC-92 are financial services, government procurement, and transport. Messerlin (1990) provides a useful summary of the EC's policies regarding services.

The market for financial services has been very fragmented in Europe, and its integration would be a major source of the gains from EC-92. The opportunities for developing countries to profit from expansion in this sector may be very limited, however, because they are not big suppliers of financial services and the EC Commission has clearly indicated that it will enforce aggressive reciprocity rules for market access.

Government procurement contracts are also potentially lucrative to outsiders. The Cecchini report estimates the gains from greater competition in this area to be worth 0.5 percent of European GDP (EEC 1988a), and there is no doubt that the internal barriers will come down. But it is not clear that any outsiders will benefit. Some sectors (such as water, transport, and energy) where developing countries could have contributed will be reserved for nationals. Local content rules may also be applied, with non-EC suppliers having to demonstrate that 50 percent (or more) of a contract's value is locally supplied in order to qualify for government business. That may remove the incentive for producers in developing countries and may also divert investment from them to local EC plants. Finally, EC governments may, as in financial services, demand reciprocity for their firms before opening up access to their contracts.

Removing restrictions on transport also offers the prospect of considerable gains for the EC, but the interests of outsiders will once more raise issues of rec-
iprocity and equal access, particularly in relation to airlines. The EC, which will take over the negotiation of routes on a bilateral basis, may not want to relax the price support given to the national carriers or to open up the already fairly extensive transport rights within the EC area without concessions elsewhere. Tourism, however, offers the developing countries much better prospects. For many countries tourism is an important foreign exchange source and has a high income elasticity. Growth in the EC should produce strong growth in tourist receipts.

**Standards**

Firms outside the EC fear the setting of standards as something over which they have no control. Standards could be manipulated against the interests of non-EC firms. Greenaway (1992) cites the case of high-definition television, where no standards have yet been adopted. The EC might set standards somewhat different from those of the rest of the world to suit its own producers and place other producers at a disadvantage. Testing—particularly important for agricultural food and health products—could also be complicated, which raises transactions costs for outsiders.

**Factors of Production**

Removing barriers to the mobility of labor and capital (harmonizing qualifications or social security arrangements and removing capital controls, for example) is an essential part of EC-92. This issue has two implications for developing countries. The first is that increasing capital mobility makes it easier to divert investment away from outsiders. Second, the EC has traditionally absorbed large numbers of unskilled workers from North and West Africa, Turkey, and the Indian subcontinent: there have been few internal barriers for the past decade, so new internal migration on any scale seems unlikely. But with the advent of a single market (and then a single currency) accentuating regional inequalities in unemployment, the pressure for internal migration will inevitably grow. As that happens, EC citizens will presumably get priority over non-EC migrants. The EC’s immigration rules will also have to be harmonized. That harmonization may well be downward to meet the demands of the most restrictive members. Arguably this is already happening, with East European labor likely to displace labor from developing countries. Thus, the developing countries stand to suffer losses of remittances from their migrant workers, which in many cases are a vital source of foreign exchange and, in a smaller way, of capital.

**Aid**

Three issues are important here: the general system of preferences, the Lomé Convention, and aid disbursements. The system of trading preferences is
already severely constrained by quotas and the general reduction of tariffs. The EC-92 program is not intended to change that. The Lomé Convention is also intended to continue as it is.

EC-92 may affect direct aid disbursements for the poorer developing countries in two ways. First, aid may be tied to the EC as a whole rather than to a specific country. Donor countries tie aid in order to internalize some of the benefits, so they are unlikely to give up the practice. But the main gain here would be the ability of developing countries to choose the cheapest supplier within the EC, raising the real value of that aid. The completion of the internal market, however, will accentuate the structural adjustment needs of the poorer, declining, and peripheral regions of the EC. Regional inequalities within the EC are already much larger than within any of its constituent countries, and they are widening. The single market is likely to accelerate that process. At the same time, pressure to reduce fiscal deficits in the EC countries is also increasing. It therefore seems inevitable that more public money will be devoted to fiscal transfers and structural adjustment programs within Europe. On top of that, monetary integration requires greater fiscal activity if regional divergences are to be contained. It is hard to see how all this can occur without reducing the aid budgets for the developing countries.

The Impact of EC-92 on Developing Countries’ Trade:
Empirical Estimates

Few empirical studies of the effects of EC-92 on trade are available, even though the central questions—trade creation versus trade diversion, the terms of trade, and the impact of imperfect competition and investment diversion—are essentially empirical. The EC’s own analysis of the effects of EC-92 emphasized the increase in total output resulting from the efficiency and income gains within the EC itself (EEC 1988b). Other things being equal, this implies increased imports. But there are also going to be lower prices within the EC. If the relative costs between the EC and other suppliers change, then applying a conventional measure of income elasticity, without allowing for an unfavorable relative price effect on outside suppliers, is not correct. Further, a higher estimate of the effect on income (or finding a dynamic effect on the rate, and not just the level, of growth), which would increase external trade, can occur only if the initial trade effects are also positive.

Trade Creation Outside the EC

The EC’s analysts calculated that the rise in EC income as a result of the single market would be 5 percent over five years. That implies a small but plausible increase of roughly 1 percent in GDP each year. Any conventional import elasticity can be applied to this. If developing countries are assumed to be con-
strained by balance of payments problems—a reasonable assumption at the moment—an upper limit for their gains can be obtained. The results tend to be small because the EC forms only part of their markets and tends to import goods relatively insensitive to changes in income. These income effects are higher for the more advanced exporters of manufactures. Given the low shares and import elasticities in the EC and rather higher elasticities in the developing countries, the relation is likely to be less than half a point in income growth for every extra point on EC growth and substantially below that for the poorest countries (Page 1991).

A standard estimate of the income elasticity of EC imports would be about two, implying that the demand for non-EC products would rise by 10 percent over five years, or 2 percent each year, as a result of EC-92. That income elasticity estimate would not be accepted by all, and the range of estimates in the literature does suggest that the trade creation effect is likely to vary considerably over different product groups and different supplying countries (Page 1991). And within individual product groups the additional effects of EC commercial policies (quotas on textiles, voluntary restraints on consumer electronics and cars, domestic agricultural price supports, coffee excise taxes, and so on) will become increasingly important. We have no specific information on the average effect of the external barriers to be expected after EC-92.

**Trade Diversion Outside the EC**

Trade diversion will be greatest for low-value, undifferentiated, price-elastic goods such as textiles, clothing, footwear, leather, consumer products and simple electronics, metals, and chemicals. It will be lowest for noncompeting primary goods and specialized high-value goods. In other words, the typical NIE and middle-income developing country stands to lose its export trade in manufactures to EC firms (Page 1991). But the commodity producers and the non-European economies of the Organization for Economic Co-operation and Development are likely to be relatively unaffected by trade diversion.

The EC's estimates of trade diversion suggest that EC imports will fall about 2.5 percent as a result of removing internal barriers to trade and a further 7.5 percent as a result of removing restrictions that have impeded scale economies and full comparative advantage across the EC (Cawley and Davenport 1988). On top of this decline, the Cecchini report (EEC 1988a, 1988b) estimates that the terms of trade for the non-EC countries will deteriorate by about 0.5 percent. Thus, according to the EC's own estimates, the trade creation and trade diversion effects on outsiders will roughly cancel each other out—leaving the non-EC countries somewhat worse off because of the terms-of-trade effects on their own imports. However, since the literature contains a wide variety of estimated price and income elasticities, different authors may come up with alternative assessments, especially if they look at different product groups or producing countries. For example, Davenport (1990), who estimates income

A. J. Hughes Hallett
elasticity at about 2, sees trade diversion canceling out trade creation for developing country manufactured exports, whereas Langhammer (1990), whose estimates of income elasticity are much higher (5.5), contends that trade creation would outweigh trade diversion by a factor of four.

Investment Diversion Outside the EC

To complete the estimation of the effects of EC-92 on outsiders, we need some idea of the size and likely consequences of investment diversion. Unfortunately, there have been no studies on which to base firm estimates, but the effect must be to worsen the position of developing countries somewhat further and may easily turn an insignificant loss on the trade account into a significant loss overall.

Trade Creation and Diversion in Imperfectly Competitive Markets

Our earlier discussion suggested that imperfect competition before 1992 would exaggerate the gains (and losses) because more trade would be reoriented, perhaps even to the extent of converting trade diversion into a trade reversal. Smith and Venables (1988) explore this possibility in a ten-industry model and find that EC-92 would, for those industries, raise both trade within the EC and EC exports to the rest of the world, while also reducing EC imports and raising the EC's GDP. The size of the change would vary from industry to industry, depending on the production structure and degree of imperfect competition. Winters (1991) quotes a typical example (office equipment) with 45 percent more internal trade, but 26 percent fewer imports into the EC and 6 percent greater exports from the EC. That is not going to do the developing countries (or other non-EC economies) any good at all. Even stronger results may be obtained in the more concentrated industries with larger economies of scale and more integrated markets. The point here is that imperfect competition clearly matters more than eliminating internal barriers, causing sharper falls in EC imports and possibly starting a trade reversal in which the EC increases its share of the markets in other countries. The question then is how much of that imperfect competition will actually get removed by integrating existing markets.

Many of the calculations designed to gauge the effects of EC-92 on different industries and countries must, of necessity, be incomplete or approximate. As a result, the empirical assessments offered by different authors tend to vary depending on the definitions, assumptions, and data used. The scope of this article does not allow us to adjudicate between the estimates, but the direction of the effects (good, bad, or indifferent) can be assessed by combining the theoretical propositions described in the introductory discussion with the empirical evidence presented in subsequent sections (table 2). Even if some of the

Table 2. Summary of Likely Effects of EC-92 on Non-EC Economies

<table>
<thead>
<tr>
<th>Likely effect</th>
<th>Non-EC relative to EC countries</th>
<th>Developing relative to non-EC industrial countries</th>
<th>Exporters of manufactures relative to commodities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual EC-92 changes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No internal legal barriers</td>
<td>–</td>
<td>0</td>
<td>–</td>
</tr>
<tr>
<td>No country preferences</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Transport restrictions</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>No border controls</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Private services</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Public procurement</td>
<td>?</td>
<td>+</td>
<td>?</td>
</tr>
<tr>
<td>Standards</td>
<td>–</td>
<td>–</td>
<td>0</td>
</tr>
<tr>
<td>Total effects on goods</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increased trade from higher income</td>
<td>–</td>
<td>–</td>
<td>+</td>
</tr>
<tr>
<td>Trade diversion: competitive markets</td>
<td>–</td>
<td>+</td>
<td>–</td>
</tr>
<tr>
<td>Trade diversion: imperfectly competitive markets</td>
<td>–</td>
<td>?</td>
<td>–</td>
</tr>
<tr>
<td>Net effects: competitive markets</td>
<td>–</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Net effects: imperfectly competitive markets</td>
<td>–</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Effects on investment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>From structural changes</td>
<td>?</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>From increased income</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Effect on labor</td>
<td>–</td>
<td>–</td>
<td>?</td>
</tr>
</tbody>
</table>


Individual empirical estimates lack credibility, the signs of spillover effects of EC-92 look fairly convincing on both theoretical and empirical grounds.

Dissenting Estimates: Will Anything Happen at All?

At this point it is worth pausing to consider whether EC-92 really will produce the increases in competitive pressure, as well as the higher growth and lower prices that have been predicted. That nothing at all may happen is, perhaps, an extreme view. But Kay (1991) points out that removing internal barriers, harmonizing standards and mutual recognition, or creating simpler financial conditions for exporting will actually make exporting and multilateral control (that is, mergers and acquisitions) more attractive. Conversely, barriers tend to foster collaboration or the establishment of plants abroad to get around these constraints. And the empirical evidence for 1983–88 supports that; mergers and acquisitions in the EC have increased as market access has increased. In fact, during that period, collaborative or complementarity agreements have been maintained only across (as opposed to within) the EC boundaries. Exactly
similar trends can be found in the development of the United States as an established single market. Increased merger and acquisition activity, with the remaining firms trying to go it alone in the expanded EC market, is bound to have some anticompetitive consequences. It will certainly ensure the continued fragmentation of European industry, instead of promoting greater scale economies and comparative advantage. Thus, according to Kay, the EC Commission's own evidence does not support its own arguments. If he is right, the gains in incomes and prices may well turn out to be much smaller than advertised.

Another dissenting voice is Hamilton (1991), who argues that removing national import quotas and the internal barriers of Article 115 will have little, if any, effect on prices within the EC. He also argues that any increase in EC income levels will have little impact on many developing country exporters because the thousands of voluntary export restraints are defined in terms of volumes. Hence, as the EC economy expands, those restraints will tighten and transfer larger rents abroad. Thus, unless the voluntary restraints are repealed (and that hardly seems likely), EC-92 will have only a small effect on the developing countries—and a considerably smaller effect than estimates based on fixed exogenous restraints (including estimates of price and income elasticities based on the assumption of fixed restraints) would suggest. This conclusion is very much at variance with the "official" estimates (Cecchini 1988; Sapir 1990; Winters 1988). Once again, it is important to note these arguments and to be prepared to revise one's estimates of the impact of EC-92 down rather than up.

EC-92's Effects on Manufacturing and Commodity Trade

Langhammer (1990) points out that price and income elasticities vary among different classes of goods; and that, in practice, the elasticities themselves (as well as the product-by-product differences between them) tend to rise with increasing disaggregation. But the cross-price elasticities and the impact of the budget constraints from developments in other markets must go in the opposite direction because, even if certain market (or commodity) responses become more elastic individually, they cannot at the same time become more elastic in aggregate. If they did, any rise in national income (or fall in the price level) would trigger a larger total expenditure and hence burst a budget constraint somewhere. Instead the greater elasticities found on disaggregation will be compensated by adjustments in other markets. Hence partial equilibrium results on a product-by-product basis, which assume no interactions between markets, are of little interest because they ignore the spillovers onto or restrictions leading back from neighboring markets. We need to use general equilibrium results instead.

Similarly, price and income elasticities for individual countries or for the developing countries or the NIEs as a group will differ from any estimates for the
non-EC countries taken as a whole because of differences in economic structure, trade patterns, and economic policies.

At this stage, general equilibrium analyses of the impacts of EC-92 are in their infancy and have been undertaken only for the European Free Trade Association and for Japan and some Asian NIEs (Haaland 1990; Stoeckel, Pearce, and Banks 1990). Nevertheless, it is possible to give broad estimates, based on the usual partial equilibrium approach of the likely effects of EC-92 on product groups such as manufactures, primary commodities, and services or on certain country groups such as Asian NIEs, the Organization of Petroleum Exporting Countries (OPEC), the Association of Southeast Asian Nations (ASEAN), Sub-Saharan Africa, and Latin America. Davenport (1990), Davenport and Page (1990), Page (1991), Langhammer (1990), Matthews and McAleese (1990), Nicolaides (1990), and Stevens (1990) give disaggregated results of that kind. The partial nature of such an approach may not be too restrictive if the product groups can be chosen to fit with the usual separability patterns of demand systems.

**Trade Patterns after EC-92**

The EC imports more primary than manufactured goods from developing countries. The trade-creation and trade-diversion effects will reinforce this tendency. Manufactured goods may well have higher-than-average income elasticities, as Langhammer (1990) claims, but the relatively simple manufactures that developing countries export (textiles, clothing, food products, consumer products, chemicals, and steel) also have higher price elasticities. Moreover, competition from aggressive emerging industries in southern Europe is likely to increase. So a significant expansion of the trade in developing country manufactures is not likely; and trade diversion will tend to offset any trade creation.

Conversely, the income elasticities for primary commodity exports may be smaller than those for manufactures. But the price elasticities are, in most cases, smaller still. Consequently, trade creation is more likely to dominate any diversion here. The net effect will be to reinforce existing trade patterns and to obstruct both those developing countries that are making a serious attempt to diversify away from dependence on one or two primary commodity markets (especially if their strategy is to diversify into manufacturing industries) and those Latin American and Asian countries that are trying to diversify away from dependence on the U.S. or Japanese markets (see Page 1991).

**The Impact on Manufacturing Output by Country Group**

If EC-92 reinforces existing trading patterns, how are the developing economies likely to fare? Table 3, which is taken from Page (1991), gives some typical estimates by country group. The total effects on any one group are pretty small. Positive trade-creation effects are offset by negative trade-diversion fig-
### Table 3. Estimates of EC-92 Effects on Exports from Developing Countries

<table>
<thead>
<tr>
<th>Country group</th>
<th>Additional exports to the EC</th>
<th>Diversion effects (in all manufactures)</th>
<th>Percentage of exports of total exports</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Primary manufactures</td>
<td>Percentage to the EC</td>
<td></td>
</tr>
<tr>
<td>All developing countries</td>
<td>2,804</td>
<td>4,434</td>
<td>-5,655</td>
</tr>
<tr>
<td>ACP</td>
<td>534</td>
<td>315</td>
<td>-477</td>
</tr>
<tr>
<td>Maghreb countries</td>
<td>244</td>
<td>370</td>
<td>-534</td>
</tr>
<tr>
<td>South Asia and China</td>
<td>86</td>
<td>920</td>
<td>-1,125</td>
</tr>
<tr>
<td>Four Asian NIEs</td>
<td>12</td>
<td>2,574</td>
<td>-4,077</td>
</tr>
<tr>
<td>ASEAN countries</td>
<td>102</td>
<td>344</td>
<td>-464</td>
</tr>
<tr>
<td>Western Hemisphere</td>
<td>502</td>
<td>495</td>
<td>-751</td>
</tr>
<tr>
<td>OPEC</td>
<td>1,156</td>
<td>515</td>
<td>-847</td>
</tr>
</tbody>
</table>


ures, so that none of the groups’ total exports is changed by more than 1 percent. Of course, the effect on exports to the EC itself is larger; 6 percent down for the NIEs, 4 percent up for OPEC, with the other country groups falling somewhere between the two. But those figures are also remarkable for being so small when year-on-year changes in exports of 10–20 percent are not unusual.

Very small price elasticities for primary commodities and fuels ensure that the diversion effects are all felt in the manufacturing sector. The conjecture that EC-92 will reinforce existing trade patterns is therefore confirmed; trade creation expands the EC’s imports of primary commodities, but trade diversion outweighs trade creation in manufactures in every case. Thus:

- EC-92 will dampen trade in manufactured goods in all developing country groups, making their attempts to diversify more difficult and reinforcing their dependence on prices in a few commodity markets.

- EC-92 will have a small but positive effect on developing country exports to the EC but the gains will be very unevenly distributed. Commodity-dependent economies, such as those in the African, Caribbean, and Pacific states (ACP) and OPEC countries, will gain on average. But those with significant manufacturing activities, principally the Asian NIEs and ASEAN economies, will lose out by almost as much as the others gain. Most of the African and Latin American economies will be less affected.

- The net effects of EC-92 on output and trade in the developing countries are likely to be quite small (0.3 percent of total exports offset by a negative terms-of-trade effect as well as an ambiguous import effect because the demand for competing imports will fall while some inputs to production become cheaper). The more serious effects are the obstruction of diversification and the problems caused by investment diversion. Damage here would have serious long-term consequences (as yet unquantified).
The estimates of income and price elasticities underlying table 3 are between 0.5 and 0.7 for nonfuel primary commodities, 1.2 for fuels, and from around 2 for manufactures to 2.4 for machinery and transport (Page 1991). Price elasticities are effectively zero for primary commodities as a group (intercommodity substitution among these developing country groups being negligible). They are around 5 for chemicals, machinery, and transport (because these are easily substituted by EC products) and 2 for other manufactures that are less easily substituted. Such estimates fit into the range of figures preferred by most authors looking at the pattern of overall EC trade (see, for instance, Winters 1991; Davenport 1990; Cecchini 1988; Matthews and McAleese 1990). But there have been other estimates. Langhammer (1990), with a higher income and lower price elasticity, concludes that created trade will outweigh diverted trade by a factor of four. On that basis, the results in table 3 would be reversed, and the developing countries would gain from EC-92 on all counts—including diversification and investment. But Langhammer does not explain why his estimated elasticity (at 5.5) is so much higher than those of other studies (in a wide-ranging survey, Goldstein and Khan [1985] find income elasticities of 1 to 2.5 for different categories of manufactured imports). Moreover, Langhammer’s positive price elasticity (+1.5), which implies that falling EC prices would divert trade toward the developing countries, could only be appropriate in the unlikely event that the existing national quotas are abolished instead of translated into EC-wide quotas. Langhammer also acknowledges that the effects of EC-92 on developing country manufactures are not likely to be dramatic and notes that EC imports of developing country manufactures have actually been falling compared with U.S. imports of the same throughout 1968–85, a period of greater integration and liberalization of the European markets. Both of those observations support the estimates set out in table 3 rather than the alternatives.

Davenport (1990) also concludes that the effects on developing country manufactures will be relatively minor because trade created roughly balances trade diverted. Most countries in his sample of eighteen Asian or Latin American developing countries show small gains in certain industries (for example, textiles), but those gains are substantially smaller than the average annual growth of 5 to 7 percent experienced during the past decade. According to Davenport greater negative effects are to be expected from diverting investment and from tightening either the existing national import quotas or voluntary restraints, or even from extending the restrictions to an EC-wide basis, because that would end the current practice of transferring unused quotas from one national import market to another. Calculations for textiles suggest that developing country exports to the EC would increase by only a fifth of the potential expansion implied by EC-92’s trade creation. One may expect further quota restrictions on consumer electronics (to safeguard Europe’s high-tech potential), footwear, household goods, and cars, because investigations of the EC’s vulnerability in these markets are already under way or complete. Davenport argues that these
are likely to involve EC-wide voluntary restraints that lie outside the scope of EC-92. But, as usual, no figures on investment diversion are forthcoming.

The Impact on Commodity Producers

Finally, Matthews and McAleese (1990), in their study of the effects of EC-92 on producers of primary commodities, provide further evidence to support the estimates in table 3. They put the growth effect across four commodity groups at an extra 6 percent of exports to the EC, or an extra 1.2 percent of total exports. To this, the change in the terms of trade would add another 0.1 percent. But of the total increase of 1.3 percent, just one-quarter would go to non-oil producers and three-quarters to the oil countries. And of that one-quarter share, most (two-thirds) would go to food and beverages, so the minerals producers would see very little benefit. Thus, the effects continue to be small and poorly distributed across different product groups and commodity producers. But the net outcome is at least positive in each case.

Matthews and McAleese also note that the fiscal regime, more than the agricultural supports within the Common Agricultural Policy, will have a big effect on commodity producers. One problem here is the harmonization of value added tax among EC members, which will raise EC taxes on food imports because food is zero-rated in some member countries. Technical and health standards on food products could also be important. Finally, the Common Agricultural Policy has a whole range of price supports that distort trade in foodstuffs. As always, it is not clear what will happen to these items, but it is unlikely that existing taxes and restrictions will be lowered. So the estimates in table 3 probably give a reasonable picture of the effects of EC-92 on different commodity producers.

Conclusions

EC-92’s greatest effect on developing countries will probably not come from marginal changes in trade flows dependent on relatively small changes in prices and incomes. Nor will it come from cuts in average costs, from the removal of internal barriers to trade and the free movement of factors, or from a 5 percent increase in EC output. Those changes may be important to European policymakers, but they are only of remote interest to developing countries. The main threats to developing countries are the diversion of investment funds to EC countries, the continuation of external barriers (especially administrative, non-tariff barriers) and perhaps significant changes in market structure.

The EC expects the single market to promote higher growth and lower prices as firms exploit comparative advantages and economies of scale more effectively—and as competition among firms increases. The net effect on developing countries of removing internal trade barriers depends on developing countries’
income and price elasticities with the EC. Current estimates suggest that the effect will be small.

Competition among European firms is likely to increase if the single market reduces collaborative agreements between firms. But those gains may not materialize if firms merge or cooperate to increase their market share or compete against U.S. or Japanese firms. Similarly if new external barriers emerge or if EC-wide barriers replace national barriers in an effort to protect EC firms, developing countries' trade in manufactures or services will suffer. But perhaps the most damaging development would be EC-92's tendency to reinforce the developing countries' dependence on existing trade patterns, thwarting their attempts to diversify away from such risky markets to a wider economic base with better growth prospects.

Investment in EC countries may increase to meet the extra demand, growth, or trade diversion resulting from EC-92. That could lead to increased investments in developing countries. However, given limited financial resources, tight monetary policies and the indebtedness in developing countries, it is more likely to divert investment funds from developing countries, thus limiting their future growth. And U.S. and Japanese firms, fearing greater EC barriers and local-content rules, may decide to establish bases in the EC.

Technical standards in EC-92 may be tougher than national standards in member countries, which could hurt exporters in developing countries. An increase in voluntary export restraints, a tightening of local-content rules or reciprocity agreements, and subsidies for public sector enterprises or agriculture could also make life more difficult for them.

Is Fortress Europe likely? The EC Commission says no, but the Community's record so far is not good. The Common Agricultural Policy is the most blatant example of protectionism. Another example is the local-content requirement. Others are the pyramid of preferential trading agreements and the increasing use of nontariff barriers against low-tech, labor-intensive exports from the developing countries and against high-tech exports from the United States and Japan.

These barriers are likely to remain; no official commitment to their removal has been forthcoming. The question is whether the (average) barriers will be raised to protect the least efficient producers in the EC and whether they will be raised to the level of the highest preferential trading agreements. If national barriers are converted to EC-wide protection, there is a good chance that external barriers will increase. If so, they may do so by only a small amount, because a single market will force Article 115 to be abandoned. An external tariff that allows efficient producers to profit from the protection of the less efficient would conflict too obviously with the stated objective of greater internal competition.

Notes

A. J. Hughes Hallett is with the Department of Economics at Princeton University and the University of Strathclyde, Glasgow. This article arises out of a larger project of the International
Economics Department at the World Bank to analyze structural changes in world trade and identify their effect on exports from developing countries.

1. Consisting, respectively, of Australia, Hong Kong, Indonesia, Japan, the Republic of Korea, Malaysia, New Zealand, the Philippines, Singapore, Taiwan, and Thailand (that is, the Asia-Pacific Economic Cooperation initiative, plus Hong Kong and Taiwan); and of the United States, Canada, and Mexico.

2. The Lomé Convention comprises a series of trade and economic cooperation agreements, first signed in Lomé, Togo, in 1975 and ratified and extended periodically thereafter, between the EC and the countries from the African, Caribbean, and Pacific states (ACP).

3. Wolf (1987) points to those taxation effects; Hamilton (1991) focuses on the gains to non-EC suppliers from the rent transfers implied by the EC quota system.

4. This figure, often used by the media when reviewing EC aid policy, appears, if anything, to be an underestimate. Greenaway (1991) sets direct aid expenditures by EC countries at between 0.03 percent of GNP for Ireland and 0.4 percent of GNP for the Netherlands. The EC average is around 0.25 percent of GNP. Meanwhile, EC trade with the developing countries as a whole amounts to 3.4 percent of the EC's GNP (EEC 1989). Hence, to spend two ECUs on keeping out imports from developing countries for every ECU spent in aid would involve trade barriers amounting to 0.5 percent of the EC's GNP, or the equivalent of a 14.3 percent tariff on the prices of developing country imports. But the agricultural policies of the EC countries are estimated to have increased agricultural prices in those countries by 70 percent (Anderson and Tyers 1990). Because the remaining EC trade barriers cost up to 2 percent of that trade (Winters 1991), non-agricultural exports from developing countries cannot suffer less than the equivalent of a tariff of 2 percent—actually much more because trade in textiles, clothing, footwear, consumer electronics, and so on are subject to much sharper restrictions than that. The share of agriculture in developing country production is approximately 18 percent overall (World Bank 1989). Based on those figures, the average tariff equivalent on exports from the developing countries is 14.2 percent, which equals 0.5 percent of EC GNP, or two ECUs for each ECU of aid.

5. This estimate must be regarded as very tentative. Baldwin (1989) argues that it is too small by a factor of two. But Peck (1989) and Backhoven (1990) think it is too large by a factor of two. The EC's preferred estimate is therefore a midpoint, and it is said to incorporate most of the dynamic gains.

6. This is because the EC Commission apparently manipulated its survey questions and made selective use of the results to obtain the evidence it quotes. A wider view of the evidence, according to Kay (1991), suggests the opposite conclusions.

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