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WORKING PAPERS

ECONOMIC INTERDEPENDENCE - NEW POLICY CHALLENGES

PROCEEDINGS OF THE PUBLIC HEARING HELD BY THE COMMITTEE ON EXTERNAL ECONOMIC RELATIONS

BRUSSELS, 28 SEPTEMBER 1993.

External Economic Relations Series

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PROCEEDINGS OF THE PUBLIC HEARING HELD BY THE COMMITTEE ON EXTERNAL ECONOMIC RELATIONS UNDER THE CHAIRMANSHIP OF MR. WILLY DE CLERCQ PRESIDENT OF THE COMMITTEE

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FOREWORD

On 25 January 1993 the European Parliament's Committee on External Economic Relations decided to organise a Public Hearing with the aim of improving its understanding of the ongoing process of economic interdependence in the world and its consequences for the European Union's economy and trade policy. The information gathered should help the Committee in setting out its future policy lines. The hearing was held in Brussels on 28 September 1993. In order to provide the Members with valuable background material and to serve as a reference for future debate on the issues involved, the Directorate General for Research has been requested to publish the proceedings of the hearing.

The present document includes the papers of experts and policy makers on the basis of which the discussions were organised. It consists of the following parts: (I) An introduction, in which the Chairman of the Committee sets out the purpose and the framework of the Hearing, and introduces speakers and discussants invited to the meeting; (II) A discussion paper prepared by the Commission taking stock of the issue and presenting its views on policy implications for the European Union; (III) The proceedings of the Hearing, including the presentations of speakers and the interventions by discussants and Members; (IV) Submissions by representatives of interests groups.

It should be noted that, due to technical problems during the afternoon session, not all parts of the discussion could be reproduced.

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I. INTRODUCTION

BY MR WILLY DE CLERCQ, CHAIRMAN OF THE COMMITTEE ON EXTERNAL ECONOMIC RELATIONS

It may be asked why there should be a public hearing on the globalization of the economy. During this legislature, our committee, which is responsible for the Community's external economic relations, has dealt with the different aspects of this phenomenon from various angles, inter alia as part of the parliamentary proceedings relating to the Uruguay Round multilateral trade negotiations in the GATT, textiles, commerce, the environment, social clauses and anti-dumping policy and the implementation of the common trade policy. All the reports drawn up by our colleagues on these subjects deal with the problems of economic interdependence and its repercussions on trade policy, but none of them has made an overall detailed analysis of the globalization of the economy.

Our committee therefore decided to hold this hearing in order to sound out the views of leading academics and politicians on this subject which affects trade policy as a whole. Given the quality of the experts among us today, I am sure that our debates and discussions will enable us to have a greater understanding of this subject. Naturally, it will be up to the Members of the European Parliament elected for the next legislature who will be able to act upon this information. Nevertheless, the European Parliament must draw conclusions therefrom in the form of an own-initiative report by the REX committee which will be debated in plenary sitting.

What is economic interdependence or, to use another term, the globalization of the economy? Initially, our answer can be based on the following facts: since the second world war, the growth rate of international trade has been consistently higher than the GDP growth rate of the industrialized countries through trade in goods. Direct foreign investment has been constantly on the increase. More recently, strong links have been forged between undertakings established in different countries as a result of growing trade. Multinational companies have been set up and today there is a real network criss-crossing the whole world or at least all the older and newly industrialized countries and a number of developing countries.

This trend has been encouraged or at least made possible by the opening up of markets between the different countries under the multilateral trading system established by GATT. In the course of successive rounds of multilateral negotiations customs duties, the main obstacle to trade in the post-war period, have been substantially reduced. Over the last two decades, this strategy of opening up the markets has proved to be both increasingly insufficient and also unadapted to circumstances - insufficient in that it does not take account of other obstacles to trade and investment and unadapted to circumstances because the political consequences of opening up markets without any accompanying policy have sometimes been open to criticism, particularly the adverse effects of unfair competition, whether real or imagined.

The total or near-total absence of international harmonization of social and environmental policies means that a successful (in strictly economic terms) exporter may be accused of 'social dumping', if labour legislation in the exporting country does not correspond to that of the importing country, or 'environmental dumping' if the products manufactured in the exporting country do not comply with the environmental protection standards used in the importing countries. A tendency towards protectionism is apparent almost everywhere.

The guests on our first panel, in particular the first two speakers, Professor TSOUKALIS, Professor of Economics at the University of Athens and the College of Europe in Bruges, and Professor DORNBUSCH, Ford International Professor of Economics at the Massachusetts Institute of Technology, (Cambridge, United States) who, despite his university commitments, has agreed to come to Europe for several hours and give us his views on the globalization of the economy, will lead us straight to the heart of the matter, as viewed from a European and an American perspective respectively.

After we have heard these two speeches, the next speakers will be:

- Mr Michel ALBERT, Executive Chairman of Assurances Générales de France in Paris, who will comment on these two controversial speeches from the standpoint of a European businessman;

- Mr Noël G. SINCLAIR, Deputy Permanent Secretary of the Sistema Económico Latinoamericana (SELA) in Caracas (Venezuela), who will analyze the two positions from the standpoint of the developing Latin American countries;

- Mr Hai-Hyung CHO, Executive Chairman of Nara Corporation, Seoul (South Korea), who will comment in his capacity as a businessman from a newly industrialized country in the most dynamic region of the world.

What are the policy consequences of economic interdependence? The increasing globalisation of economic activities has made traditional concepts of national economic policy more and more obsolete. Governments which were slow or reluctant to recognise these facts have nowadays a common responsibility to promote the interest of their populations and to pursue their objectives in a way which does not undermine the interests of their neighbours. Globalisation has thus placed severe limitations on the effectiveness of national policies and regulations. This holds true as well for the Community even though among Member States the relevant part of legislation has been harmonised. But an economic entity as big as the EC cannot rely exclusively on its own. It is embedded into the wider transglobal economic context. The active role the EC is playing in the negotiations of the Uruguay Round is a proof that EC policy makers are very much aware of these facts.

Our afternoon session will be devoted to discuss these policy consequences. Great or industrial policy decisions which fail to take account of economic globalisation by which foreign trade is often replaced by foreign direct investment or that both can be substituted by so-called networking arrangements are unlikely to prove effective. Equally, trade or investment related decisions can be heavily affected by developments in the international monetary system. Even the largest economies are finding it increasingly difficult to steer a genuinly independent policy course. Autonomous economic growth is no longer possible for anyone. It is, therefore, increasingly urgent to develop more effective mechanismn for macroeconomic policy coordination than those currently available.

Such a cooperation is still lagging behind the pace of economic development while substantial steps had been taken in developing a multilateral trade regime which should be further enhanced when the Uruguay Round negotiations, as we all hope, will be completed by the end of this year. We are still far from establishing a multilateral framework for international policy coordination which would be adequate to today's economic reality. Therefore, the development of multilateral rules for the other forms of international economic activity must be envisaged as the next step before us. They concern more convergent competition policy rules, a comprehensive regime for foreign direct investments, as well as trade related and environmental measures.

The process of globalisation calls for a radical adjustment of thinking and policies on the part of decision makers. A more collaborative, less adversarial approach to multilateral activities is required for a successful management of an increasingly interdependent world economic system.

On this question the contribution of Vice-President Sir Leon BRITTAN who will speak to us this afternoon will be focussed. The comments of our primary discussants will deal with this problem from the point of view of

- a european industrialist: Mr Ton VAN HEESCH, Managing Director of PHILIPS, Eindhoven (NL);
- a representative of the most successful exporting country, namely Japan, Mr Kazuo CHIBA, former Ambassador of his country to the U.K. and Counsellor of Mitsui & Co. Ltd., Tokyo;
- a representative of the interests of workers, Mr Denis MACSHANE, Secretary of the International Metal Workers Federation, Geneva.

II. INTERNATIONAL ECONOMIC INTERDEPENDENCE

DISCUSSION PAPER, COMMISSION OF THE EUROPEAN COMMUNITY,
DIRECTORATE GENERAL
FOR EXTERNAL ECONOMIC RELATIONS, MAY 1993.

EXECUTIVE SUMMARY

In today's increasingly multipolar world, economic issues are gaining in relative significance. It is important, therefore, to understand the radical changes which are occurring in the world economy. Economic interdependence has always existed to a certain degree. However, the technological advances of the last forty years or so and the ensuing increasingly global nature of production have resulted in a quantitative and qualitative change in the degree and nature of this interdependence. Sustained economic growth has become increasingly dependent on freedom to engage in economic exchange and other activities across national boundaries.

Foreign direct investment and the emergence of multinational and, increasingly, global private enterprises have played a key role in these developments. The trend has also been reinforced by the proliferation of other, often more complex, forms of international alliances and link-ups between economic operators seeking to reduce costs, customise their products and spread the risks of producing goods or providing services in a rapidly changing technological and economic environment. This type of "networking" can be expected to gain in momentum with the further evolution of computer aided production techniques and of communications and information transfer systems. It is suggested that there is a need for a deeper examination of the significance of newer forms of transnational economic activity based on various forms of networking and the implications of these developments in policy terms, both for the Community and at the international level.

Foreign trade has also developed rapidly over the last few decades, at a higher rate than the growth of world output, contributing to and reflecting the self-reinforcing process of globalisation. Its structure has undergone substantial changes. Trade in manufactured intermediate goods represents an important part of the trade of industrialised countries, illustrating the increasing internationalism of production. Furthermore, a large part of world trade now consists of trade within multinational companies.

The increasing globalisation of economic activity has, in practice, invalidated traditional concepts of national interest, a fact that governments have been slow or reluctant to recognise. Governments increasingly have a shared responsibility to promote the interests they have in common and pursue their objectives in a way which does not undermine the latter. Globalisation has also placed severe limitations on the effectiveness of national policies and regulations. Moreover, traditional policy delimitations are becoming increasingly meaningless as the forms of activity undertaken by economic operators and the motives underlying these become more complex. Thus trade or industrial policy decisions, for example, which fail to take account of the fact that foreign direct investment often replaces trade or that networking arrangements can be a substitute for both forms of activity, are unlikely to prove effective. Equally, trade or investment related decisions can be overwhelmed by international monetary developments, and so on.

The extensive and increasingly pervasive interlinkages between economies or regional entities have created multiple channels for the rapid transmission of economic effects across national borders. Even the largest economies are finding it increasingly difficult to steer a genuinely independent policy course. Autonomous economic growth is no longer possible for anyone: the welfare of any country or entity is intricately bound up with that of its partners. It is, therefore, increasingly urgent to develop more effective mechanisms for macroeconomic policy coordination than those currently available.

The case for broad based economic liberalisation and for developing multilateral cooperation in the face of the de facto changes, brought about largely by private sector activity, is overwhelming. Yet such cooperation has tended to lag behind the pace of developments. While substantial steps have been taken in developing a multilateral trade regime, which should be further enhanced when the current Uruguay Round negotiations are completed, we are still far from establishing a multilateral/international framework equal to the requirements of today's economic reality. The development of multilateral rules governing the other rapidly growing forms of economic activity is the next step in the process. In particular, this paper suggests that competition policy rules, a rationalised and comprehensive regime for foreign direct investment, as well as trade-related environmental measures are the three priorities for the post-Uruguay Round agenda.

The development of a global financial market of massive proportions has further intensified economic interdependence. Many aspects of interdependence are largely restricted to the western industrialised world. Although the group of industrial countries has been enlarged with the emergence of new dynamic economies, particularly in S.E. Asia, a substantial part of the third world remains marginalised, in absolute or relative terms. Similarly, the centrally planned economies, former and actual, have been cut off from the developments in the rest of the industrialised world. However, other forms of interdependence, economic, political, environmental etc., link the industrialised and the developing economies. This disequilibrium in the world economy prevents the realisation of its full potential, as well as engendering political and social instability. The industrialised countries, therefore, have an interest in promoting the economic growth in these countries and their full integration into the world economic system.

The process of globalisation calls for a substantial adjustment of thinking and policies, on the part of decision makers. A more collaborative, less adversarial approach to multilateral initiatives is required for the successful management of an increasingly interdependent world economic system.

I. INTRODUCTION

(i) Towards a Global Economy

The end of the cold war put an end to the bi-polar world of the super powers. It has become commonplace to speak of the new world order, even if few people would still define this new order in the same optimistic spirit in which the phrase was originally coined. Nevertheless, few would contest that an important feature of the new order is its multipolarity. The observed parallel trend towards greater political and economic multipolarity calls for a reassessment of concepts, policies and institutions, which developed in earlier and substantially different conditions. In the new context, economic issues have gained in relative importance as traditional geopolitical and security concerns have receded. It is, therefore, particularly important that we recognise and understand the changes that are occurring in the world economy and, hence, develop appropriate policies which will assure global stability and economic prosperity.

Economic interdependence between states is not a new phenomenon. Differences in terms of factor endowments, particularly natural resources, and other comparative advantages have always meant that individual economies have been dependent, to a greater or lesser extent, on international trade. However, in the course of the last forty years this interdependence has undergone a qualitative change and reached an unprecedented level, largely driven by the steady progress of scientific knowledge and the ensuing technology.

The technological advances of recent decades years have revolutionised telecommunications and transport and have opened up new possibilities with respect to distribution of goods and factors of production, handling of data, automation, etc., which have attenuated or even severed the links between location of production and markets or sources of raw materials, and have resulted in a complete revision of traditional notions of economies of scale, of business organisation and delimitation of markets. Even more important, they have resulted in the rapid expansion of service-related activities, based on the expansion of information networks, whose contribution to the national economies of the industrially advanced countries has become predominant. These trends are set to continue and even intensify.

Sustainable growth has, accordingly, become increasingly dependent on access to an expanding and, ultimately, a global, albeit non-uniform, market. This period has seen a steady increase in international economic exchange, in a self-reinforcing process of transnational interlinkage and interdependence between economies. Not only has there been a steady increase in the volume of goods and services traded on an international level but flows of short-term capital and direct investment have come to be directed with decreasing regard to national boundaries. The development of an international financial market, and the rapid growth of international portfolio investment, as well as the spread of multinational or transnational companies, have been instrumental in deepening and extending the linkages and dependencies between countries.

Equally, transnational cooperation - state or private sector initiated -in research and development, production and marketing, in infrastructure projects etc., has been expanding. Indeed, qualitatively new forms of international alliances or link-ups have developed whereby value-creating activities are carried out jointly by different operators acting across national borders. This type of activity, often referred to as "economic networking," is particularly prevalent in services (banking, transport etc.) as well as in certain high-tech industries. The introduction of computer-aided design, production, marketing and maintenance systems can be expected to promote the spread of economic networking into more traditional areas. It is clear, therefore, that the expansion of transnational economic activity, which is becoming increasingly globalised, has created a substantial and growing degree of interdependence between economies. Moreover, the forms of interdependence have become more complex and often more intangible and less easy to quantify than in the past.

(ii) Policy Interdependence

Private initiative has, generally, been at the forefront of the above changes, which have taken place despite the existence of various barriers to international economic activity. Governments have in general been slower to recognise and respond to the new reality. They have tended to cling to traditional notions of national interest and to yield to pressure from specific interests groups threatened by change. Understandably enough, they have been unwilling to admit that their freedom of action with respect to macroeconomic policy making has been eroded. They have also been slow to recognise that most of the global challenges which they have to face if their prosperity, political stability and ecological equilibrium are to be maintained cannot be addressed by any single government, however rich and powerful.

Although valuable efforts have been made to co-ordinate macroeconomic policies and substantial steps have been taken to multilateralise rules and regulations in some areas of international activity, most notably trade, these have tended to lag behind the rapid pace of the new developments. Furthermore, the rationale for these efforts has still in large measure been based on a "national" concept of interest which is becoming less relevant as globalisation proceeds. Consequently, the institutional means available for managing international economic activity, for addressing its social, environmental and other consequences and for assuring the international cooperation, public and private, necessary to make the most of the new possibilities offered by scientific and technological progress, are not in general adequate to the task.

The emergence of regional integration/cooperation initiatives reflects an implicit or explicit recognition of interdependence and of the consequent need for liberalisation of economic activity and plurilateral collaboration. At the same time, however, it is becoming increasingly acknowledged that helpful as regional cooperation initiatives may be, the expansion of transnational economic interchange requires greater cooperation at the multilateral/international level not only to promote liberalisation but also to develop the necessary structures for the management of an increasingly globalised economy.

2. ASPECTS OF INTERDEPENDENCE

(i) Foreign Trade

General trends

Foreign trade is the oldest manifestation of international economic interdependence. However, the rapid expansion of world trade in recent decades, at a rate higher than that of world output growth, and the changes in its relative composition and geographic distribution have contributed to and reflect the qualitative difference in the nature and degree of interdependence which has occurred over this period.

According to GATT estimates, world trade increased by 67% in volume terms during the seventies and by a further 49% during the following decade, against 48 and 34% in world production respectively (Table 1). This was accompanied by an increase in the number of countries engaged in world trade. Shifts also occurred in the international division of labour as production of labour intensive products increasingly moved from the industrialised to the developing countries, particularly the newly industrialised economies. Thus, the share in world trade of manufactured products exports from the developing countries (including the NIEs) rose steadily in value terms, from 5.4% in 1970 to 15.7% in 1990. However, the share of total developing country exports in world trade (including energy products) has, after a short lived upsurge in the period 1979-84 remained at around 20% throughout most of the last three decades.

For their part, the industrialised countries continue to dominate international trade activity, accounting for more than two thirds of world trade, while trade among the group represents around half of the total. The bulk (two thirds) of developing countries' exports continues to be directed towards the industrialised countries, although trade among the former has increased in the two decades in question, accounting for 5.8% of world trade in 1990, as against 3.5% in 1970 (with some fluctuations in between).

Merchandise trade now represents 30% of world GDP as against 19% in 1960 (Table 2). If services are included, the corresponding figures are nearly 40% today compared to 20% in 1960.

The product structure of world trade has also changed over this period. The volume of trade in manufactured products has grown faster than the other main product categories as defined by GATT (agricultural and mining products - the latter includes energy products), in almost every year in the last three decades. This has been mirrored by a more or less steady increase in the contribution, in value terms, of manufactured products trade to total merchandise trade from around 50% in 1960 to around 70% by the beginning of the nineties. The period has also seen a rapid development in trade in services, which have, generally, also been growing faster than the national product. Although in overall terms growth in services trade did not exceed the growth in trade in goods, particular service sectors did outpace the latter. In the eighties, commercial services as a whole grew on average 2 percentage points faster than world merchandise trade, according to GATT figures (Table 3).

Trade in intermediate manufactured goods

Perhaps the most significant development in interdependence terms is the growth of intra-industry trade and trade in intermediate products (parts and semi-finished products) in general. This phenomenon, which characterises trade between the industrialised countries, reveals the high degree of internationalisation of production through foreign direct investment and economic networking operations.

A recent OECD study[1] shows that direct imports of manufactured intermediate inputs accounts for between 50-70% of all manufactured imports into the five countries examined (Canada, France, Germany, the UK and the US), and the rate of growth of these intermediate imports as higher than the rate of growth of domestic sourcing over the period early seventies to mid eighties. The ratio of foreign to domestic sourcing in these countries ranged from 50% (Canada) to 7% (Japan). The use (direct and indirect) of imported intermediate inputs was found to be particularly high in petroleum refining, textiles, clothing and footwear, motor vehicles, computers, aerospace, communication equipment and semiconductors.

EC trade flows with Japan and the US also confirm the growing interdependence between the production processes of the Triad countries and similar links with other important economic partners. Approximately one-third of EC imports and over 40% of EC exports from and to the US, Japan and EFTA consist of intermediate manufactured goods.

A large part of trade in intermediate products is the result of intra-company movements of such inputs within multinational enterprises. It is estimated that intra-firm trade accounts for around 30% of exports and up to 40-50% of imports of the US, Japan and the UK[2]. Overall, the share of intra-firm trade in world trade is estimated at 25%[3]. The role of multinationals in promoting the expansion of trade is seen to be even greater if one looks at the total trade generated by these companies. The same sources estimate that multinationals generate exports accounting for at least 50% of exports from the US, 40% of Japanese exports and as much as 80% of UK exports. Overall, multinationals generate at least 40% of all world trade. At the same time, however, to the extent that their target is local market sales, they are also substituting potential trade flows by local production. Thus, it has been estimated that local sales of US subsidiaries in some of its major trading partners are greater (up to four or five times as great) than US exports to these countries. Similarly local sales of foreign subsidiaries in the US are 1.5 times higher than total US imports.

The above developments highlight the limitations of an approach to trade policy which is too compartmentalised and which relies too heavily on traditional, overall trade balance considerations and ignores the structure of trade and other important economic indicators.

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1 The International Sourcing of Intermediate Inputs: By Canada, France Germany, Japan, The UK and the US, DSTI/STII/IND(92)1/Rev(1), OECD, March 1992.

2 C.MICHALET, *The Activities of Multinational Enterprises and their Effects on International Trade*, OECD, July 1991, TD/TC/WP9(91)43.

3 World Investment Report 1992, *Transnational Corporations as Engines of Growth* - United Nations, 1992.

(ii) Foreign Direct Investment

A motor of globalisation

Foreign direct investment (FDI) has become an increasingly important activity over the last twenty years or so. World FDI outflows in the previous decade grew at an annual average rate of almost 30%[1], more than three times the rate of world exports and four times as fast as world gross domestic product. This trend, which will almost certainly be maintained, has led to a situation where annual direct investment flows in 1989 stood at $196 bn as compared to a level of world exports of $3039 billion. Furthermore, if one takes into account the contribution to world trade of multinational companies described in the preceding section, the importance of this form of international activity becomes even more evident. To quote the UN's World Investment Report 1991 "... in much the same way that burgeoning trade linkages drove international economic growth and integration in the 1950s and 1960s, FDI is fuelling growth and integration in the 1990s."

The motivation behind corporate decisions to undertake foreign investment is diverse but can be grouped under the two broad categories of cost and/or market considerations, including trade substitution and import barrier evasion. Foreign investment decisions in the period in question were founded on both types of motivation. The economic growth of the eighties, coupled with the trend towards greater liberalisation and deregulation, particularly in the services sector, gave FDI an additional impulse. As with other forms of international exchange, the bulk of FDI activity occurs among the industrialised countries.

The main actors

Japan, the UK, the United States, France and Germany are the main source of foreign investment. In the period 1986-1990 **this group accounted for 70% of the world average outflow.** Developed countries in total accounted for 96.8%. **One interesting recent development is the entry of the newly industrialised economies, notably the Asian NIEs, on the FDI scene.** As a result, FDI flows from developing countries have increased more than sevenfold in the space of five years although they still represent only 3% of world FDI outflows.

As host countries also, the developed economies attract the lion's share of FDI inflows - more than 80% of the total in 1990 (Table 4). For their part, the developing countries have lost ground, with their share falling from 25% of world inflows in the early eighties to 17% by the end of the decade. More than half of this subtotal is directed to South and South-East Asia, a third to Latin America and the Caribbean, while Africa attracts less than a tenth. The economic marginalisation of much of the developing world is reflected in these figures. For others, chiefly the NIEs of S.E Asia and certain Latin American countries, foreign investment, motivated by global strategy rather than local sales considerations, has been instrumental in promoting their export-led development.

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1 This and most other figures in this section are from: World Investment Report: *the Triad in Foreign Direct Investment*, United Nations, 1991 and World Investment Report 1992, United Nations, 1992.

The rapid advance of Japanese FDI outflows means that Japan is fast increasing its share of the total stock of foreign investment. While Europe (i.e. UK, F, D, NL and I), has maintained its share at around 36% (largely through the rapid expansion of intra-EC investment), Japan's part has grown from just under 1% in 1960 to 16.9% in 1988 and the US share has slipped from 47% to 30.3% over the same period.

Foreign direct investment has become particularly important in the services sector. Although in earlier decades FDI was concentrated in raw materials and other primary products, today the main sectors are services and technology-intensive manufacturing (Table 5). More than 70% of Japanese foreign investment, and around 60% of US investment are in services. For Community countries, the share of services is generally lower and chemicals and energy account for more than half of foreign investment (with the exception of Germany for which the share of services is over 60%).

Multinational corporations (MNCs) are a major source of FDI flows, by which foreign affiliates are set up or acquired. The UN estimates the present total number of MNCs at (at least) 35,000, with some 148,000 foreign affiliates (Table 6). Nearly 90% of MNCs are based in developed countries, and the links with developing economies are mainly through foreign affiliates, with more than 40% of affiliates located in the latter. Most MNCs are small or medium-sized. A small number of MNCs account for the majority of outward FDI in individual countries. For example, in France, 350 MNCs accounted for 80% of all outflows in 1981-1984. The employment offered by foreign affiliates is considerable. For subsidiaries linked with companies in Japan, Germany and the US, it totals 10m jobs in 1990 (Table 7).

Increasing multilateral cooperation

The above developments have taken place against a very varied regulatory background. Multilateral cooperation initiatives have been undertaken in this area in the OECD and more recently in the GATT and the TRIMS (Trade Related Investment Measures) negotiations. In addition, UN agencies and the World Bank have also addressed various issues of relevance to FDI. However, the issues involved have generally been dealt with in a fragmented fashion. Bilateral agreements to address concerns with respect to host country treatment of investment, particularly in the developing world, have also proliferated.

A consensus of opinion is gradually emerging in favour of an agreement on a rationalised and more comprehensive multilateral framework for foreign direct investment. This is discussed in greater detail in Chapter III, section iv) below.

(iii) Globalisation of Technology

Growing interdependence

Technological resources and R&D activities remain largely concentrated in the Triad countries (US, Japan, EC). The dependence of countries outside this group on Triad technology is therefore very substantial and transfer of this thechno-logy, generally through direct investment by Triad multinational enterprises, is of prime importance. Within the Triad, the level of technological interdependence is high and increasing further, particularly in the new high-tech areas, prompting the coining of terms such as "techno-globalism". Here too, direct investment plays an important part in technology transfer and it is increasingly the case that multinationals are decentralising

R&D activities, particularly in applied research, in order to facilitate the customisation of production to fit the needs of local markets and to take advantage of local human and technological resources.

FDI and Mergers and Acquisitions (M&As)

Foreign direct investment can take place through acquisitions of existing firms or through the creation of new firms and production facilities ("green-field" investment). The input and output structure of production tends to remain largely unaltered when existing firms change hands, at least not in the short run. The creation of new production facilities, however, is more likely to entail new international input-output patterns.

In the US, acquisitions accounted for nearly 85% of foreign investment outlays in the last decade, while in the EC around 60% of recent foreign direct investment occurred through acquisitions. These acquisitions were for a large part concentrated in process industries, where there are important economies of scale in production, marketing and/or possibilities of spreading the costs of high R&D (e.g. chemicals).

Cross-border mergers and acquisitions in Europe totalled ECU 45.3 bn in 1989, and ECU 30.4 bn in the first half of 1990, with the US as the main single acquiring nation and the EC clearly the largest acquiring entity. By far the most important "target" was the EC itself, accounting for around 90% of these flows (Table 8).

Apart from FDI, other forms of cross-border business linkages have also grown rapidly. Cross-border minority holdings and joint ventures in the EC both in industry and services accounted for more than half of all EC minority acquisitions and joint ventures taking place in the second half of the eighties (Tables 9-10).

Sources:
OECD, Industrial Policy in OECD Countries, annual review 1992, Paris 1992.
CEC, Panorama of EC Industries 1991-1992, Luxembourg, 1992.
CEC, XXIst Report on Competition Policy, Brussels, 1992.

International collaboration

At the same time, although most inter-firm agreements in this area still take place within the same country or region, cross-border collaboration between companies in industrial R&D and innovation has come to play an important role in certain industries such as semiconductors, computers, automation, telecommunications, biotechnology, as well as in a number of more traditional areas such as chemicals and automobiles.

The motivation for technology collaboration is based not only on market considerations but also on the need to reduce the uncertainty and costs of R&D and to spread the risks involved. It takes many forms including research corporations, joint R&D agreements, second sourcing and licensing agreements. This type of cooperation has also been stimulated by the growing need to cope with the complexity of new technologies as well as the high degree of interlinkage between them, and to reduce the innovation time span or product development time. This makes it increasingly difficult for a single company, no matter how big, to cover the areas of research required for its strategic development and leads in turn to collaboration between companies with both related and complementary technology.

Empirical research on the motives for inter-firm cooperation in general indicates that cooperation agreements related to technology complementarity and reduction of innovation time span have become as important as those related to market access considerations, which were the main motive force in the seventies. Thus, one recent study found 31% of the inter-company agreements examined were motivated by technology complementarity, 28% by the wish to reduce the innovation time span and 32% by market considerations. Not surprisingly, the technology related considerations were particularly strong in the high-tech sectors, while for traditional sectors the tendency was for market motivations to be stronger. Similar findings could be expected from an analysis limited only to international inter-firm alliances.

International cooperation in government sponsored R&D and innovation activities is much less widespread, although the advantages of sharing costs, particularly in expensive basic research, are beginning to make an impact on government attitudes. Nevertheless, many restrictions on such cooperation, often justified in national security grounds, remain in force.

As for cooperation between industry and university or other research establishments, this still is largely confined within countries or regions. It is, however, expected that the general trend for greater cross-border cooperation will eventually extend to this area also.

The contradiction between traditional government policies with respect to technology related issues and the reality of growing international interdependence in this area mirrors the general lack of adaptation by national/community decision makers to the prevailing conditions governing economic activity. **A re-evaluation of the presumptions on which these policies are based, particularly with respect to national security, would seem necessary.** In this context, the importance of technology transfer in the effort to bring about the fuller integration of the less developed parts of the world in the global economic system should be highlighted.

(iv) Transnational Information Flows and Networks

A booming sector

Data communication services are one of the most rapidly expanding areas of economic activity. On a global level this sector has, over the last decade, been growing at an annual rate of over 40%, by volume. In the Community, the telecommunications market accounts for around 6% of gross national product. Of this the services element represents about 80%. Although voice transmission makes up the bulk of these services, its growth rate is relatively low, 10-15% per annum in volume terms in most industrialised countries or 5-7% in value terms. The real growth area is in the wide range of data, image and video signal transfers, which in the EC is growing at an estimated annual rate of 20% in value terms. This trend is expected to intensify with the new generation of services made technically possible by the progressive replacement of the old telephone network by the Integrated Services Digital Network (ISDN) and by the progress of deregulation.

At present, international communications represent barely 2% of the total communications volume on the telephone network. In particular, data communications via this network do not even reach a significant volume, largely because of the system's real or perceived poor performance and inappropriate pricing schemes. The further development of tele data processing and information services is linked to the development of communication facilities and services.

The conversion of the old analog telephone system to the ISDN, a process which will be completed before the end of the decade in most western countries, will alter the situation dramatically. One immediate outcome will be that many services currently supported by other transmission means, will be transformed to ISDN. These services, will include features such as high quality facsimile, graphic data transmission, high speed information transfers, multilateral video conference (more exotic services such as TV à la carte, video telephone and many others will probably not become widely available until the next century).

The rapid expansion of these new services can be expected to outstrip the growth of voice communications and, in the long run, they could become more important in absolute economic terms. Their most visible effect will be the creation of new markets to the detriment of some existing ones: multilateral video conference will significantly reduce business trips, reliable high quality facsimile will undoubtedly have a negative impact on traditional mail, while fast and reliable data transfer is likely to change radically our practices in administration, commerce and data exchange. In practice, these developments will result in a growing convergence of public and private communication networks and will call for international rule-making. The new data transfer possibilities will certainly give an added boost to the process of economic globalisation.

Repercussions for the developing world

The spread of data communication services and networks will, inevitably continue to be concentrated in the first instance, in the industrialised world. The question arises, whether this will act as a disincentive to foreign investment in the developing countries and hinder their fuller integration into the world economy.

In the absence of positive action to promote the necessary public and private expenditure, there is a very real danger that the poorer of the developing countries will be unable to undertake the substantial infrastructure costs involved. Although a number of third world economies, such as India, are making intense efforts to introduce new technologies, notably satellite and mobile communications networks, others are unable to mobilise the necessary funds and human and technological resources to follow suit and thus run the risk of becoming even more peripheral than at present.

(v) Economic Networking

The developments outlined in the preceding section have been instrumental in promoting the spread of new forms of corporate strategies at the international level. These strategies are based concurrently **on cooperation and competition** between economic operators engaged in various forms of joint value-creating activity. The resulting interrelationships are usually referred to as "networking" while some analysts now increasingly speak of the emergence of a "networked economy".

Convergence of Public and Private Networks

One of the most important practical outcomes of the ISDN is the blending of voice, data and video transmission both at the national and international level. In fact, once ISDN becomes fully operational, it will be virtually impossible for the carrier companies to split voice and data services as at present and harder for governments to implement restrictive policies in this sector. Deregulation, spurred on by the new technology, will intensify and private carriers will be able to use the public ISDN infrastructure adding services to the network, Value Added Networks or VANS, in competition with the traditional monopolies in activities other than voice transmission.

So far, public and private carriers have carried out vertical integration policies: the carrier in most cases owns both the physical infrastructure and provides the services offered to the customers. In the case of public carriers, vertical integration has often gone much further to include the manufacture and distribution of network and terminal equipment, telecommunication computers, phone sets, modems, etc. Deregulation is likely to cut the present vertical sectors into horizontal layers. The telecommunications infrastructure will be owned by public and private carriers while private and public companies will develop and offer Value Added Network services on top of the previous layer.

In overall terms, therefore, corporate networking is moving towards increased utilisation of public facilities and, increasingly, public infrastructure is being used as an integral part of the private infrastructure. This trend should be further reinforced, as the costs, coverage and reliability of public networks improve and as international standardisation and deregulation proceed, even if certain sectors such as banking and some sensitive defence related industries continue to maintain their existing closed networks.

The future landscape of international communications is likely to be one in which many private companies offering value added services over networks with international coverage, compete for the provision of these services with public carriers. Transnational joint ventures can also be expected to increase. Already such joint projects, notably between European, Japanese and US carriers and users, are being set up in the face of the high investment costs of introducing the new technologies.

The economic potential of these developments is enormous. It is estimated that 80% of international data interchange relates to trade, transport and administrative activities. Only a small proportion of this is currently transmitted by electronic means, and much of the electronic data interchange which does take place is via private infrastructures and uses non-standard message formats. The savings in administrative infrastructure which could accrue from the introduction of electronic standard message transfers could, according to estimates of some private companies, be as high as 40%. Thus adding substantial cost benefits to the advantages of greater rapidity and accuracy of transmission.

A clear indication of the degree of international interdependence in this area is the development of the UN initiative on Electronic Data Inter- Interchange for Administration, Commerce and Trade (EDIFACT). The EDIFACT regional boards, are responsible for the elaboration of standard messages for international information interchange. It is expected that, by the end of the century, standard formats will have been developed for most messages, thus enabling interlocutors across the world to overcome linguistic as well as geographic barriers and to interchange orders, invoices, data etc. quickly and efficiently.

In addition, for the new services described above to become fully operational and widely accepted various legal and security problems have to be solved, for example, electronic signatures, data privacy, and Intellectual Property protection. The pressure will grow for greater international cooperation among governments to rationalise and improve the existing regulatory framework.

The above developments raise issues concerning the social aspects of telecommunications. The provision of certain minimum services have to be assured for social reasons (e.g. in unprofitable rural or other remote regions). These considerations apply primarily to basic voice communications, the so-called "reserved" services. A degree of policy intervention will inevitably remain not only for social reasons but, equally, because of national security considerations.

Of even greater long-term importance are the social and cultural changes implied by the changes in working practices brought about by the new communication possibilities. A foretaste of the kind of radical changes, including the globalisation effect, is given by the revolution in financial markets which has already occurred.

These relationships include: simple exchange of information via electronic data interchange (EDI) systems; more advanced types of corporate alliances such as cross-licensing arrangements, R&D consortia or joint ventures and other forms of co-production; as well as alliances for moulding the environment within which the companies in question operate, for example by developing common norms or by influencing the regulatory framework.

Networking is most prevalent in the services sector. Such economic linkages are particularly advanced in the area of professional services while financial services are increasingly relying on networking arrangements to develop their business in foreign markets as an alternative to cross-border provision of services or of direct investment. However, similar arrangements are also becoming more widespread in the manufacturing industry, particularly in the high tech areas of microelectronics, computers etc. Networking arrangements can cover activities ranging from the research and development stage through to the production and marketing phases. This introduces a greater element of flexibility in the operation of companies, which in turn, permits them to adapt their output to the specific needs of differentiated and variable markets and cope more effectively with competition, short product life cycles and rapid technological change.

Chemical companies and more traditional sectors such as automobiles are also discovering the benefits of competitive cooperation, particularly in data exchange. This trend can be expected to continue and to spread to cooperation in production and distribution as modern production and control technology, such as computer-aided design, manufacturing and marketing, becomes more widespread in a greater range of industrial sectors.

Assessing the total volume of current economic activity covered by networking is not easy, and few if any estimates have been published. It is equally difficult to evaluate the policy ramifications. **What is clear is that it increases the complexity of international linkages and erodes further the effectiveness of national policies and regulation.** The impact on competition, to name but one area, can be positive or negative depending on the specific circumstances. On the one hand, networking arrangements can increase the risk of cartelisation. On the other hand, such arrangements can raise the prospects of survival for small firms who might otherwise be unable to compete.

This is an area which merits deeper examination in order to assess the implications in terms of policies and priorities.

(vi) Financial Markets

The emergence of a global financial market is the most highly developed and pervasive aspect of economic interdependence. The advances in informatics and communications technology, within the last ten years, have permitted the development of instantaneous and continuous trading in currencies and financial assets across the world, thus creating the most truly global market. The size of this market is enormous. The turnover of foreign exchange markets alone amounts to $900 billion per day, three times more than the equivalent value in 1986. The current annual turnover in cross-border equity transactions adds up to $1.4 trillion, compared to $120 billion in 1980, a figure which corresponds to 7% of world GDP. The outstanding stock of international bonds and principal derivatives in 1991 stood at $8.6 trillion, corresponding to 40% of world GDP[1], while "international" bank lending (cross-border lending plus domestic lending denominated in foreign currency) rose from $324 billion in 1980 to $7.5 trillion in 1990. With pension funds, which are the major institutional investors, also increasingly entering the international financial markets, many of these trends will be reinforced. Currently, only 5% of the total assets held by US pensions funds of $3.3 trillion is invested outside the country, and only 8% of Japanese pension funds of $2.2 trillion. The equivalent figure for European funds is higher, about 20%. These percentages are expected to double for the US and Japan within the next few years as asset diversification increases and legal obstacles to cross-border investments are lowered. This is likely to give a substantial further impulse to international financial markets.

This unprecedented mobility of capital has its positive and negative aspects. On the one hand it can help to assure the most efficient utilisation of capital at world level. On the other hand, it does hold potential dangers, particularly in the present institutional set-up.

The globalisation of financial markets has had a profound effect on the extent and degree of macroeconomic interdependence. As a result of the sheer volume of funds involved and the speed with which markets can respond to events, the impact of market developments can be both massive and immediate. Hence, the effects of changes in policy variables which influence the financial markets in one country, can be transmitted very rapidly to others. The total non-gold reserves of all industrial countries in 1992 stood at around $550 billion, or 40% less than the daily turnover in foreign exchange markets. Action by monetary authorities to influence exchange rates, which is deemed to be unwise can, therefore, be quickly swamped by the response of the markets.

Global financial markets, therefore, exercise a powerful discipline on national governments and limit the extent to which they can pursue a genuinely independent policy course. As long as market behaviour reflects real economic fundamentals, the effect of market discipline should be beneficial. However, it is also true that the potentially destabilising effects of simple speculation are now much greater. In addition, the complexity and extent of interlinkages between financial systems can in themselves generate new risks of breakdown and other malfunctioning permeating throughout the system. Apart from this system-risk, the complex interlinkages can also facilitate misuse of the system (e.g. money-laundering).

[1] The Economist of 19/09/1992, Financial Times 04/05/1993 and 06/05/1993.

3. POLICY IMPLICATIONS

(i) A Stable and Open World Economy

The various forms of international economic activity described in the preceding chapter make up an intensive and complex system of global interdependence. The interlinkages between individual economies are too strong and the momentum of globalisation too great for the process to be reversed. In such a system, where wealth-creating activities are increasingly transnational, it makes sense to facilitate these activities by providing an open and stable world economic environment. It also makes sense to provide an international regulatory framework. The effort required to achieve the latter is likely to be far less than the cost of non-cooperation at the multilateral level.

Managing a global economy

A stable macroeconomic environment implies effective policy co-ordination between governments, at least of those economies whose size is such that they can have a significant impact on the global economy. The need for this is intensified by the increasing multipolarity of the world economic system. No single economy is large enough to assure the stability of the system or act as its engine of growth. The stability and predictability of the international economic environment can only be achieved through concertation among the main economies.

The economic welfare of the citizens of any country or entity like the European Community is intricately bound up with the prosperity of other economies. All economies are involved in the same self-reinforcing dynamic process which can, in the right circumstances, lead to higher growth and welfare for everyone or, in the wrong circumstances, can spiral down into recession. Moreover, because of the stronger and more numerous links between economies, as well as the rapidity with which effects are transmitted, the positive or negative trends are likely to be stronger than in the past. Recent experience with the world recession seems to indicate that even the richest and biggest economies are finding it harder to insulate themselves from international developments or to reverse their situation in isolation.

The drive by individual countries to increase their economic competitiveness is, therefore, not necessarily a zero-sum game. A competitive edge for one economy leading to more efficient production and increasing standards of living will not necessary occur at the expense of other economies, even though it may cause difficulties for specific sectors within the latter. In fact, given the right conditions of openness and competition, it is equally likely to have the opposite effect in a dynamic, self-reinforcing process of growth, especially in the medium to long term. The greater the interlinkages between economies, the stronger this effect.

Therefore, strong competition between economies notwithstanding, countries have a common interest in assuring a stable economic and political environment, open markets and effective rules governing the multifarious forms of international economic activity.

Direct Economic Costs of Non-Liberalisation

The economic costs of inadequate liberalisation are widely recognised. The beneficial link between trade and economic growth has been demonstrated in practice, similarly other forms of international exchange have a favourable impact on growth. A failure on the part of governments to facilitate these activities within an appropriate multilateral regulatory framework and to introduce the necessary adjustment policies to reduce the short term dislocation which can cause opposition to liberalisation, would prevent the realisation of the full potential benefits and prevent a more optimal allocation of resources. While attempts to quantify these effects may yield varying results, they do at least agree on the adverse nature and significance of the impact.

The absence of a suitable framework for international economic activity may hinder but will not stop the latter. What it will do is to decrease further the capability of governments to manage their economic environment and to assure the best possible conditions for economic growth, domestically and internationally. Even in the most extreme case of a failure of the Uruguay Round and a regression into protectionism, the trend may be slowed but not reversed. This means that the costs of non-cooperation at the multilateral level will increase further with time.

One recent French study estimates that in the extreme case where the major trading blocs (EC+EFTA, NAFTA, and Japan+Asian NIE's) apply protectionist measures on inter-bloc trade, world manufacturing production would be 15% lower by the year 2000 than it would be, ceteris paribus, on the basis of current trends, as a result of a reduction of inter-bloc trade and higher than otherwise inflation rates brought about by a less efficient allocation of resources. It is interesting to note that the same model, which assumes, inter alia, a more decisive application of protectionist tools by the United States than by the Community, yields substantial regional variations in the cost of protectionism. The hardest hit are the industrialised Asian countries (-23%), who are assumed to be the primary targets of EC and US protectionist measures, these are followed by Africa and the Middle East (-16.5%), Eastern Europe (-14%), and the rest of Asia (-13.5%). Production in Western Europe is expected to be almost 13% down, while the US and Latin America are expected to be the least affected with a fall of around 7.5%.

In contrast to this, a simulation using the same model, based on the assumption of accelerated market liberalisation which leads to a rate of growth of world trade which exceeds present trends, finds that world manufacturing production would be 20% higher by the year 2000 than it would be if the present trade growth rate were continued.

Another study, based on game theory analysis. indicates that, while the EC and the U.S. may stand to lose less than others from a trilateral EC/US/ Japan trade war, nevertheless all countries are significantly better off in a world liberalisation scenario.

Models such as this inevitably oversimplify reality and their results have to be viewed with caution. For example, in the first simulation account is not taken of alternatives to trade whose development could be spurred further by a more restrictive trading environment. Nevertheless, independent qualitative analysis would lead to similar conclusions, regarding the impact of protectionism or of liberalisation, even if the magnitude of the effects and their distribution are open to discussion.

The above studies relate specifically to trade in goods. The cost of inadequate cooperation at the multilateral level, and hence the persistence of current difficulties, both for private business and for governments seeking to regulate, could be expected to be at least as substantial in services, as well as investment and other forms of international collaboration between economic operators.

References:
Economie mondiale 1990-2000: l'impératif de croissance. Centre d'Etudes Prospectives et d'Informations Internationales, Ed. Economica, 1992.

Trade Wars, Trade Negotiations and Applied Game Theory, G.W. Harrison and E.E. Rutstrom, The Economic Journal, Vol. 101, May 1991.

Economic liberalisation

In this context, an open environment means more than an open trade regime. It entails open regimes for foreign direct investment, for capital flows, for access to networks and for all forms of international economic activity. This policy option, if pursued by all concerned, is the optimum course of action. Although economic protectionism may bring some apparent short-term gains to an individual economy, it is ultimately counterproductive. It increases internal costs and it affects other economies adversely, thereby reducing their imports and their investment outflows etc. Moreover, if it provokes retaliation the negative effects are compounded further.

Economic liberalisation, of course, entails substantial and often painful structural adjustments, at the domestic and the international level. It is incumbent on governments to take the necessary action to address the negative consequences in order to ensure the long-term political viability of liberal economic policies. At the international level, a more intensive, concerted effort is called for to address the imbalance in the global distribution of wealth. At the domestic level, this action involves such measures as education and retraining, creation of alternative employment opportunities, social welfare provisions etc.

It is important to note that the same technological forces which have been the driving force behind globalisation are also responsible for the radical changes which are taking place in the nature and organisation of economic activity at the domestic level. Even the most advanced industrial countries have not yet adequately adapted the structure and skill distribution of their workforces. Neither have they adequately responded to the development of new and increasingly flexible processes for production of goods and provision of services, which in turn imply new and ever more flexible working methods and practices. It seems likely that these underlying factors have substantially aggravated the effects of low growth and recession in recent years and are, therefore, in part responsible for the sustained high levels of unemployment currently experienced by much of the industrialised world.

In such circumstances, achieving the highest possible levels of world economic growth becomes even more crucial. It offers the best environment within which to realise the difficult adjustments which have to be carried out. Trying to preserve jobs through economic protectionism will, by slowing down world growth, merely compound the problem.

The limits of national policies and regulation

The globalisation of economic activity and the resulting interdependencies and interlinkages between countries seriously curtail the ability of individual governments to carry out autonomous economic policies and to implement effective national regulation. The macroeconomic policy decisions of others can often negate the effects of particular government measures or oblige a government to abandon a preferred course of action.

Another consequence of interdependence is that the definition of national interest has become much more complex and is no longer confined within the traditional narrow geographic boundaries of the national economy. A growing part of the activity which adds to the wealth of a particular country is taking place beyond its frontiers. Even when wealth creation occurs within the economy itself, it is increasingly likely to be the result of activities carried out by foreign nationals. Accordingly, the overlap of interests between different economies is expanding[1].

The spread of regional cooperation and integration initiatives is in part a response to this reality. It reflects a degree of recognition by national governments of the limits to their effective sovereignty and their, sometimes grudging, acceptance of the fact that plurilateral cooperation is necessary in order to deal more adequately with many of the issues they have to face. The success of these initiatives have varied. Governments have often been reluctant to translate intentions into practice. The history of the European Community would seem to indicate that strong political as well as economic motivation is required, at least in the early stages, for such initiatives to take off.

Regional cooperation is often easier to establish than multilateral action because it involves fewer participants. Even if different regional models are adopted, they all ultimately rely on consensus building and as such provide useful experience for further multilateral cooperation. Moreover, regional co-ordination can reduce the number of views which have to be reconciled to arrive at a multilateral consensus. It can also provide a useful testing ground for various approaches to transnational policy-making or regulation.

The renewed efforts to reinforce and extend the multilateral trade regime, the deliberations in the GATT and the OECD on investment and on other policies which have an impact on international exchange, such as the environment, competition and security also reflect the global convergence of interests. The same can be said for existing international collaboration in the establishment of common or mutually-recognised health and safety requirements and product standards. However, it is becoming increasingly evident that interdependence between economies is rapidly reaching the point where far more than free trade or free investment flows are called for. The expansion of networking, is essentially based on the free movement of information, people, money and long-term capital, as well as goods and services. The promotion of networking and its expansion not only among industrialised countries as at present but also to the emerging market economies of the ex-Communist bloc and to the third world, implies a much broader approach to liberalisation, particularly with respect to transfer of knowledge and technology.

Globalisation of economic activity is bringing about a degree of uniformity between different economic systems. However, many differences remain in attitudes, living habits and working practices. Aspirations, social values and regulatory traditions still vary substantially. Competition for markets can, therefore, give rise to tensions and disputes arising from incompatibilities between different socio-economic systems. An internationally accepted framework of rules governing transnational economic activities, together with effective dispute settlement procedures, is the least costly way of reconciling differences between systems. Multilateral cooperation, therefore, is the ultimate response both to the growing overlap of interests arising from economic interdependence and to competing interests.

It follows from what has preceded that deregulation at the national level, which lies at the heart of an economy open to international trade, investment and other forms of transnational interchange has to be accompanied by multilaterally agreed minimum rules and practices, i.e. by international

[1] Reich, Robert B. (1990) *Who is us?*, Harvard Business Review, January-February.

regulation. The objective being to replace often unduly intrusive national controls, which may or may not be motivated by overt or covert protectionism, by a system of multilateral rules designed to facilitate economic interchange, to establish common ground rules for economic operators, which would also be more effective than national regulation in many instances, and hence ensure a more efficient functioning of an increasingly globalised economy. **Without such a multilateral framework, the full benefits of economic liberalisation will not be realised.** Bilateral, or even regional initiatives may often provide a partial answer but in many instances they are likely to prove little more than imperfect, stop-gap measures, which should not detract from efforts to achieve multilateral solutions. It goes without saying, therefore, that such intermediate steps should not take a form which contravenes existing multilateral rules and runs counter to further multilateral cooperation.

(ii) The need to address imbalances

Economic interdependence is strongest and most intricate among the countries of the industrialised world. It is by no means limited to these countries. The direct links between western industrialised economies and the ex-COMECON countries and the Third World may still be less complex but they are, nonetheless, significant and two-way. The energy dependence of Western Europe or Japan and the debt crisis of the eighties demonstrate the two-way nature of the relationships. Direct investment is also on the increase, albeit at a relatively low rate and a growing proportion of labour-intensive activities is being transferred to both the developing countries and the new market economies. Interdependence is, therefore, growing and gradually becoming more complex in form and geographically more diverse. It remains true, however, that the very poorest countries remain largely untouched and are, if anything, becoming more marginalised.

The economic interdependence between the industrialised and developing worlds is less asymmetrical than some might think, particularly if issues such as migration, the environment and drugs trafficking are taken into account. Furthermore, the potential threat to the politico-economic stability and security of the industrialised world of instability and/or conflict in either the former Soviet bloc countries or in other developing countries is substantial. The spread of fundamentalism, ethnic minority conflicts and other destabilising manifestations are fostered by economic discontent. Economic development and improved living standards in these countries is the most effective way of reducing this threat. **The present unequal distribution of the world's wealth - 80% of it is concentrated in the hands of the industrialised countries, which together account for only 20% of the global population - represents an enormous potential danger for all.**

The new market economies

The above arguments have been determinant in the case of the Central and Eastern European countries, and the CIS Republics, largely because of the proximity and size of the dangers, including the nuclear threat, as well as the ideological dimension. Although the response in market opening and financial terms may be considered inadequate, the objective has at least been clear: namely the integration of the countries involved into the democratic world's economic and political system.

The concept of partnership has been emphasised by the West and there is a deliberate effort to develop political relationships and economic interlinkages with them. The West is also encouraging localised regional cooperation such as the Visegrad initiative.

The emphasis on political and economic cooperation, on joint ventures, on their integration into the trans-European networks[1], as well as the expansion their administrative and entrepreneurial know-how help to foster a sense of common purpose. Provided political stability in the region is sustained and adequate investment resources can be mobilised, the majority of new democracies can expect a faster rate of integration into the global economy than many of the countries of the third world.

A closer partnership with the developing world

Tackling the persistent problem of underdevelopment in the Third World is in many ways harder than promoting the growth of many of the new market economies, most of which have generally well educated human resources even if administrative and economic infrastructure of the latter are often inadequate. Yet the effort has to be made, with the assistance of the industrialised countries. This is not only a moral necessity, it is in the enlightened self-interest of the industrialised world.

In addition to the issues related to political stability and global problems referred to earlier, there are sound economic reasons for helping these populous countries. Their substantial market potential can, if turned into reality, give a much needed boost to world economic growth. This will help to alleviate the pressure of large-scale migration and facilitate the substantial structural adaptations which are being undertaken by the mature economies in response to the rapidly changing technological environment.

Many of the developing countries have recognised that traditional development policies based on import substitution have hindered rather than helped their economic progress. The success of the Asian Tigers and others who adopted the export led path to growth are showing the alternative way forward. For their part, the industrialised countries have come to realise that many traditional aid recipes have not proved effective. More constructive assistance, building on the experience being gained in the assistance programmes for Central and Eastern European, with their emphasis of integration into the world economic and industrial system, is likely to prove a more fruitful alternative than earlier policies.

Involving the developing countries more fully in the international structures required to manage international economic activity will promote their economic progress and assure their political will to undertake the obligations this entails. At the same time, a more consistent effort to reinforce political relations with these countries, by engaging them in a more comprehensive and constructive political dialogue would help to promote a greater sense of commonality of interests.

[1] The establishment and development of transEuropean networks within the community in the sectors of transport, telecommuunications and energy, are provided for in the Union Treaty.

(iii) Towards a More Global and Comprehensive Regulatory Framework

One consequence of the globalisation of economic activity is that it is now more difficult to distinguish between its various forms and the motivation behind them. Its effects are also becoming less clear. Thus, foreign direct investment is partly replacing trade, a growing percentage of international trade occurs within multinational companies and networking arrangements between companies is developing as an alternative to both traditional trade and foreign direct investment. **This overlap means that statistical data on just one type of activity, such as trade, often gives only a partial, if not actually misleading, picture of the extent and nature of real economic linkages. For example, the Community's deficit in merchandise trade in recent years has been matched by a corresponding surplus in trade in services. Undue reliance on one economic indicator can lead to sub-optimal policy responses.**

As economic globalisation proceeds, a more comprehensive and more coordinated approach to international regulation is called for. The growing complexity of international economic interconnections means that the present "compartmentalisation" of regulatory issues is becoming increasingly inappropriate.

In practice, therefore, **traditional policy demarcations are becoming less relevant. This is true as much for distinctions between various sector-specific policies as for distinctions between domestic and external policies.** The dividing lines everywhere are becoming increasingly blurred. Industrial policy decisions, for example, will only correspond to the real needs of the economy if they take account of the globalisation of production. Similarly, the close inter-relationship between trade and global production means that trade policy should not be elaborated in isolation but as one element of a set of external economic policies. And both should be seen as part of a broader mix of coherent policies designed to ensure that the economy is strategically placed within the global economic system.

This blurring of distinctions should also be better reflected at the multilateral level. Steps in this direction have already been taken, for example the Uruguay Round negotiations include trade related investment measures or trade related intellectual property issues. Multilateral discussions are also taking place on environmental and other policies related to trade. The widening of the scope of the multilateral trade regime through the establishment of a Multilateral Trade Organisation dealing with a range of issues with a bearing on trade constitutes progress in the required direction, although it is questionable whether it goes far enough. In any event, this still leaves many issues, such as health, safety and environmental requirements, data protection and questions related to investment, either inadequately covered at the international level or dealt with in a fragmented manner.

It is, therefore, becoming more widely accepted that international rule-making will have to cover new areas of economic activity and address new concerns, as well as shifting current types of rules from the national to the international level and building wherever possible on existing private sector initiatives. An essential feature of such an international regime would be its trans-sectoral nature, the objective being to provide a framework which would promote competitive cooperation between economic operators and safeguard the interests of consumers and society at large.

Clearly this can only be seen as a long term objective. However recognition of the need for wider multilateral/international agreement in regulatory matters is gaining ground in academic circles, in international organisations and in many business circles. They are however, often less well accepted by governments. The European Community's own experience with interdependence at the regional level makes it more receptive to multilateral initiatives. Among the other industrialised countries, the United States has probably been among those most resistant to such ideas in recent years. The present Administration seems more aware of the realities of the global economic environment. The United States is one of the economies most implicated in the new forms of global economic organisation. American companies are heavily involved in traditional foreign investment activities. The high-tech and services sectors are becoming increasingly engaged in various networking arrangements, in an attempt to maintain their competitive position. The benefits of improved ground rules for transnational economic activity, linked with greater liberalisation, could be expected to receive a more positive response from this segment of the US private sector, which constitutes a powerful lobby in the US. In fact, companies world-wide recognise the disadvantages of multiplicity of regulatory systems and are calling for clear and predictable multilateral rules. The main problem for the United States is to overcome any "ideological" aversions to regulation in general and to regain confidence in the effectiveness of international institutions.

For the rest, the problem of reconciling the "traditional" concept of national interest with the wider interests of global economic operators is an issue which affects the approach of all countries to the question of international regulation. The Americans are not alone in having difficulties in adapting to this. Other countries, also, could well be reticent, not least the developing countries, who are often suspicious of the motives of the industrialised countries. The protraction of the Uruguay Round negotiations has helped to intensify cynicism and disillusionment with multilateral cooperation at a time when the need for this is becoming increasingly urgent. **A new, less adversarial approach to global questions, based on the recognition of interdependence, should therefore be fostered in all countries. This implies launching a systematic long term dialogue with the US, Japan and other industrialised and developing countries, both bilaterally and in multilateral forums.**

(iv) The Policy Issues

The development of a coherent multilateral system to deal adequately with global management will inevitably be a long drawn affair. It will involve, in the first instance, the identification of the relevant policy issues and the appropriate forums for addressing these issues, establishment of the necessary co-ordination between the latter and, more fundamentally, the assurance of widespread cooperation on the part of all countries concerned. This will require a systematic dialogue on both the bilateral and multilateral level. The major economies should be at the forefront of the effort. They are best placed to see the need for it and the EC, in particular, has its own unique experience to bring to the endeavour.

The institutional framework

The growing complexity of the task of managing a global economy inevitably raises the question of whether the present framework of international institutions and discussion forums is adequate. Does it provide the means for elaborating effective and cohesive multilateral initiatives?

With regard to macroeconomic co-ordination, most people would agree that the G-7 mechanism has, more often than not, failed to provide the level of policy coordination necessary to assure economic stability and growth. The problems this has caused have been compounded by the inability of international monetary institutions to cope fully with the repercussions of the globalisation of financial and money markets.

There is less of a consensus on how to remedy the situation. Macroeconomic policy is one of the core areas of state action and many governments are, understandably enough, reluctant to cede their apparent sovereignty. The fact remains, however, more extensive and binding forms of joint macroeconomic management are urgently required. **As the Community's own internal experience has shown, the greater is interdependence, the greater the need for policy convergence. Sooner or later, therefore, governments will be obliged by the growing pressure of events to develop the necessary institutional structures for more effective policy co-ordination.**

On the regulatory side, the situation is relatively better. Substantial progress has been made over the past three or four decades in the area of multilateral rule-making, especially in the trade area. Nevertheless, more needs to be done. The long overdue conclusion of the Uruguay Round will expand the multilateral system further, for example to cover trade in services and trade-related intellectual property issues, etc. This is of crucial importance. However, the matter should not stop there. An important outcome of the Uruguay Round negotiations will be the creation of a Multilateral Trade Organisation (MTO), providing a single coherent framework for existing rules under the GATT and its various Codes, as well as for the new rules which will emerge from the negotiation.

The Multilateral Trade Organisation could provide a forum for addressing many of the necessary regulatory issues. It should permit the establishment of a continuous programme of work to tackle issues in a systematic manner, at technical and political level. It is, however, too early to judge if the outcome of the negotiations will provide a sufficiently flexible and evolutive institutional structure for the work which needs to be done and whether it will be in a position to co-ordinate its activities adequately with other multilateral work. The OECD constitutes an additional, albeit restricted, forum, useful for exchanging ideas. Its deliberations on investment and other issues touch on many issues of broader application, which will ultimately have to be addressed in a more extended multilateral setting.

The situation regarding the institutions and mechanisms designed to promote economic progress in the developing world and the Central and Eastern European countries and the CIS republics, is more diverse.

There are numerous structures ranging from the ad hoc, such as the G-24 initiative, through to permanent structures such as the UN specialised agencies and the World Bank. Coherence between the activities of each has not always been assured. Similarly, there are few if any mechanisms to assure policy coherence with the other institutions and mechanisms.

The wider question remains to what extent the required international policy and regulatory framework can be developed within existing institutions, suitably adapted, or whether in the longer run new international structures need to be established. Some would argue that the time is ripe for a radical overhaul of the Bretton Woods system, and others would add the UN economic agencies. Gradual adjustments to the existing institutions is, they feel, unlikely to yield affective and coordinated multilateral management and correct global inequality. This view deserves serious consideration. **The present institutional structure was the product of the bi-polar post-war period. The world now is multipolar, particularly in economic terms. Adaptation of the system to the new economic and political reality is inevitable.** The extent and timing of the adaptation needed, whether a gradualist approach should be adopted or a radical one-step revision undertaken, is something which will have to be carefully considered.

(v) The next moves

The above reforms require new and specific political initiatives. It may take time to develop the necessary degree of political will to launch such initiatives and carry them to completion. In the meantime, work should progress as far and as fast as existing structures permit. The conclusion of the Uruguay Round will open the way to further progress in the regulatory sphere, in particular. **There is a growing consensus that priority issues here include rules governing competition policy, foreign direct investment and environmental measures.**

One of the negative aspects of the growth of multinational enterprises and economic networking is the heightened risk of cartelisation and excessive concentration of economic power on a global level. Equally, many of the obstacles to international economic activity take the form of indirect barriers to market entry. For example, some of the most effective trade barriers, intended or not, are the result of business structures and relationships which preclude or hinder entry by "outsiders". Both types of problems are best dealt with through multilaterally agreed rules to safeguard competition. Subsidies and other trade related competition issues are already being discussed in the GATT. The MTO, which will emerge from the Uruguay Round negotiations, could build on this to develop a more comprehensive framework of rules covering anti-trust issues.

Effective multilateral rules covering foreign direct investment activity are related to this. The initiative in the OECD framework for a national treatment instrument deals with one of the aspects involved. There are, however, many other regulatory issues which need to be addressed and both in the OECD and elsewhere the possibility of establishing a wider investment instrument is being mooted. Some of these issues are covered in various guidelines for multinational enterprises elaborated in the OECD itself or in UN agencies. Many are the subject of the more than 300 bilateral investment treaties which have been concluded between industrial (mainly European) and developing countries in order to promote and protect foreign direct investment. The issues covered by most of these treaties include treatment of investment by host countries, expropriation and compensation conditions and arbitration procedures, often involving mandatory recourse to the International Centre for Settlement of Investment Disputes (ICSID). The proliferation of these agreements reflects the more positive attitude of many developing countries to FDI. It is also interesting to note that the US, which initially showed little interest, has in the last decade concluded a number of such agreements. This suggests that the time could be ripe for revisiting the idea of a more comprehensive and global initiative on investment.

Such a multilateral/international initiative should ideally bring together the various policy strands involved and result in agreement on both host country treatment of foreign investment and the behaviour of the investing companies. **The advantage of this comprehensive approach is that it increases the chances of arriving, through mutual concessions, at substantial commitments on both sides.** On the host country side this would entail undertakings with respect to the fair and equitable treatment of investment, IP protection, etc., along the lines set out in many bilateral treaties. On the part of the investors, this would entail commitments on such things as working conditions, training and other social commitments, environmental undertakings and technology transfer.

Again, the MTO could begin to consider this issue, building on the agreement which will emerge from the current talks on trade-related investment measures. It could be argued that any prospective deliberations in this area would proceed more rapidly and come to fruition much earlier if the OECD, which covers the major players concerned by current foreign investment activity on both the source and host country side, were the chosen forum. However, while discussions in the OECD could serve to clarify ideas, it would be important for the discussion to be transferred as soon as possible to a forum which would permit the involvement of all players interested in foreign investment, either as source or host countries.

Many environmental problems are global and cannot be tackled by any single country or group of countries. International cooperation is either indispensable or offers a lower-cost option for dealing with environmental problems. Without such cooperation, unilateral environmental measures, whether based on genuine environmental considerations or whether serving as a pretext for protectionism, will proliferate with a destabilising effect on the multilateral system. The interface between environment and economic development, including trade, is becoming increasingly important. Both the perceived conflict between environmental protection and free trade, or between the respective views of developed and developing countries over the model and costs of environmentally sustainable development, pose new challenges for the international system. This not only calls for multilaterally agreed rules for environment protection, it also requires effective means of implementation and adequate monitoring of the effects of environmental measures on trade and vice versa, including credible dispute settlement procedures. The latter calls, inter alia, for the "greening" of the GATT/MTO.

No winners - everyone a loser

If governments fail to adapt their policies to the fact of growing economic globalisation, every one will pay the cost. There will be no winners, if multilateral cooperation fails to keep pace with global economic trends or, worse still, if retrograde steps towards greater economic protectionism are adopted.

The developing countries are likely to be the most immediate losers in a non-cooperative/or protectionist scenario and their economic marginalisation maintained or most probably accelerated further (see p.14). The integration of these countries into the world economic system would be more difficult, the less open the system and hence the fewer the opportunities for them to capitalise on their cost advantages, as well as their natural resources. Their attractiveness for foreign investors would be clearly curtailed if trade and other restrictions limit their appeal as regional (or global) export launching pads, an increasingly important motivation for foreign direct investment. The dangers of economic and political instability that economic marginalisation represents has already been discussed in section ii above. **In addition, the opportunity cost of not promoting the development of their market potential is a substantial one for the industrialised economies.**

Whether similar losses would accrue to the new market economies of Central and Eastern Europe and the ex-Soviet Union is more difficult to judge. It may be that political considerations coupled with geographic proximity would result in certain of these economies at least being encompassed in the wider European region. The risks of marginalisation of some of the new Republics of the ex-USSR are, however much greater.

In the short and medium term the industrialised countries as a group are likely to be less adversely affected in economic terms since they are better placed to compete regionally and internationally. Their international economic operators will continue to expand their transnational activities, finding ways as in the past of circumventing or overcoming the obstacles, albeit in a less efficient manner than in a setting more conducive to global business.

However, they too will pay the economic cost sooner or later. The additional costs entailed as well as the inability to carry out effectively the necessary regulatory and other policies means that even for the industrialised countries, the absolute and opportunity cost of not assuring appropriate multilateral structures will grow with time. Moreover, one could expect substantial variations in the distribution of these costs within the industrialised world, although it is by no means easy to predict who would lose out most.

It could be considered that, by virtue of their size and economic diversity, the consequences for the Community (of Twelve or more) and the United States of a situation in which multilateralism gives way to unilateralism or introverted regionalism would be less serious than for other industrialised countries. **In reality, while this argument may be valid in the short run, their reliance on international trade and the extent to which their economic operators are involved in transnational economic activity means that the economic prosperity of both is heavily dependent on the continued liberalisation of the world economy and on the evolution of multilateral cooperation.**

Equally, the belief of many, particularly in the US, that the latter's comprehensive unilateral trade and other economic legislation places it in a uniquely strong position to defend its economy overlooks the real long term economic interests involved. It ignores, moreover, the possibility that this could trigger a process of escalating economic retaliation, in which all would lose out in the longer run.

It has been argued that countries like Japan, with a global predominance in many areas of production would suffer fewer negative consequences than others and might even be better off in such a situation because of the dependence of other countries on its exported products. However, this is, for several reasons, again likely to be a short-lived prospect. **First, as the recent**

experience of the Japanese semiconductor industry illustrates, the dependence on export demand makes an economy like that of Japan very vulnerable to changes in the global economic climate, a slow-down of world demand having immediate repercussions. Furthermore, if disenchantment with the multilateral system were to lead not just to continuation of the status quo in multilateral cooperation, but to an actual regression into more active national or regional isolationism and a concomitant increase in protectionist measures, "non-essential" imports from Japan could well be considered by some as a prime target. Equally, in the longer run, other countries which have the technology could, in a protected environment, undertake production of products which under a liberal regime could be produced more competitively in Japan.

In addition, the Japanese economy is more dependent than the larger and more diversified economies of the Community and the United States on imported raw materials and energy products. **This makes Japan even more immediately vulnerable to economic and political instability in its suppliers.** It also relies heavily on trade substitution through direct investment in its largest markets and has an interest, therefore, in the maintenance of a relatively open world economy.

It may be true that the imperfect state of the present multilateral system offers Japan certain advantages which would be circumscribed if more effective multilateral rules were to be developed. However, these would seem to be outweighed by the dangers of a check on further multilateral cooperation or, even more so, of a breakdown of the existing regime. It is probably no coincidence that some of the more ambitious ideas regarding multilateral cooperation should have emanated from Japanese business circles[1].

The smaller industrialised economies are also likely to be more immediately affected than either the EC or the US in the absence of appropriate multilateral cooperation, their dependence on an open economic system being generally high. Not only would they bear the direct economic costs, they would also have a smaller margin of manoeuvre in terms of policy alternatives unless they were to align themselves with one or another regional bloc.

One of the advantages of a common multilateral regime is that it provides a more predictable environment for policy making. The increased difficulty in predicting how different players will act in the absence of multilateral cooperation and the consequent uncertainty surrounding the extent and the distribution of the costs of developing appropriate multilateral structures, means that all industrialised countries, as well as developing countries, have an interest in promoting multilateral cooperation. The greater stability that this would provide should facilitate the taking of a long-term view by governments and encourage economic growth. A stable economic environment with a comprehensive and effective multilateral regulatory framework offers an increased likelihood that all economies would benefit from the further development of the world economy.

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1 Proposal for a *world economic charter*, which would include harmonisation of costs in terms of salaries and dividends, by Akio MORITA, the Chairman of Sony, in an article in "Le Monde" 07/04/1992, p. 24

CONCLUSIONS

Globalisation of economic activity and hence growing economic interdependence is an inescapable fact, although its implications are not always fully recognised or understood.

Policy makers have to adapt their thinking and their policies to this trend if they are to succeed in managing economic developments to the benefit of their societies as a whole. A static and fragmented approach to policy making will fail to take into account the growing interlinkages and overlap of interests which are eroding traditional concepts of so-called national economic interests. A longer-term approach to economic policy-making is more necessary than ever before.

International economic interdependence means that competing economies have a common interest in assuring macroeconomic stability, an open world economic system and a multilateral framework of rules and institutions to manage global economic activity.

Economic liberalisation alone will not resolve structural problems such as unemployment or outdated production infrastructures, but it can be instrumental in creating the overall economic growth which will facilitate the necessary restructuring. The root causes of the problems have to be tackled by appropriate measures to educate and retrain workforces, to encourage investment and modernisation of capital bases, to promote R&D etc. It is important, therefore, that governments take the domestic measures necessary to assure the political viability of a policy of economic openness. It is self-defeating for individual countries to try and alleviate structural problems by protectionism.

Sustained economic growth in the new market economies and the developing countries, and their integration into the emerging global economic system will benefit the industrialised countries as well. It is in the interest of the latter to promote world-wide economic development.

In an interdependent world, the traditional adversarial approach to multilateral negotiation or coordination is becoming increasingly inappropriate. Genuine multilateral cooperation calls for a widespread recognition of the commonality of interests engendered by economic globalisation, even among competing economies. Public awareness of the real interests at stake should be increased. This will in turn permit governments to undertake the multilateral initiatives required to manage an interdependent world economic system.

TABLE 1: ANNUAL GROWTH OF WORLD GDP AND MERCHANDISE TRADE GROWTH, 1961-1992 (% change in volume)

YEAR	GDP	TRADE
1961	5,0	4,5
1962	6,4	6,5
1963	4,5	12,2
1964	7,2	10,9
1965	4,0	6,5
1966	6,4	7,6
1967	3,6	5,7
1968	5,8	10,8
1969	6,6	12,1
1970	4,1	8,6
1971	5,0	7,0
1972	5,7	8,4
1973	7,2	12,0
1974	1,6	5,3
1975	0,0	-7,2
1976	6,6	11,8
1977	4,6	4,2
1978	3,7	4,7
1979	3,7	5,1
1980	1,3	2,5
1981	1,5	0,5
1982	0,5	-3,0
1983	2,5	2,5
1984	4,5	8,0
1985	3,5	2,5
1986	3,0	4,5
1987	3,5	5,5
1988	4,5	8,5
1989	3,5	7,0
1990	2,0	5,0
1991	0,5	3,0
1992	1,5	4,0
1961-70	5,3	7,7
1971-80	3,9	5,3
1981-90	2,9	4,1

Sources: EUROSTAT
GATT

TABLE 2: MERCHANDISE TRADE/GDP RATIO. 1960-1990

	1960	1970	1980	1985	1990
World	**18.5**	**20.6**	**33.4**	**29.6**	**30.0**
OECD	18.0	21.4	34.1	30.4	30.9
EC (12) intra + extra	30.4	34.6	46.3	51.8	45.5
EC (12) extra	18.6	16.8	22.3	23.7	18.7
EFTA	43.4	47.6	58.0	59.2	53.3
USA	6.9	8.2	17.8	14.6	16.9
Japan	19.3	18.8	25.5	22.7	17.7
Eastern Europe (1)	12.2	13.2	17.6	17.9	12.2
PECOs	16.3	20.4	24.4	21.3	15.5
USSR	7.3	7.2	11.5	12.5	9.7
LDCs	30.4	29.0	48.6	39.7	46.4
Latin America (2)	27.8	21.6	27.4	25.6	22.1
Africa	36.5	35.0	48.1	33.5	41.3
North Africa	41.6	38.6	56.8	35.2	37.4
Middle East (3)	38.2	42.8	76.2	42.1	40.6
South & S.East Asia	25.3	26.4	54.7	52.2	71.4
NIEs	67.1	76.0 116.6	110.3		119.6
China	10.6	5.9	12.9	15.4	16.4

(1) Eastern Europe: Albania, Bulgaria, Czechoslovakia, Germany (former Democratic Republic), Hungary, Poland Romania and the former USSR.

(2) Including Caribbean

(3) Middle East: Bahrain, Cyprus, Iran, Iraq, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syria, Turkey, United Arab Emirates and Yemen.

Sources: UN Handbook of international trade and development statistics, latest issue.

Eurostat 1990 6A and Eurostat Basic statistics of the Community.

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TABLE 3: PRODUCT COMPOSITION OF WORLD EXPORTS, 1970-1990
(Percentage based on value data)

	SHARE IN WORLD EXPORTS			AVERAGE ANNUAL CHANGE IN EXPORTS	
	1970	1980	1990	1980-89	1990
Merchandise	81	83	81	4 1/2	13
Commercial services	19	17	19	6 1/2	17
	100	**100**	**100**		
Agricultural products	16 1/2	12 1/2	10	3 1/2	6 1/2
Mining products	12	22	11 1/2	-4 1/2	17 1/2
Manufuctures	50	45 1/2	57	8	13 1/2
Transportation	8 1/2	7 1/2	6	3 1/2	15 1/2
Travel	5 1/2	4	5 1/2	8 1/2	20 1/2
Other private services and income	6	6	7	7 1/2	15 1/2

Source: GATT

TABLE 4: FOREIGN DIRECT INVESTMENT INWARD FLOWS, BY REGION AND 1980-1990
(Millions of dollars)

Host region/ economy	1980-1985 (Annual average)	1988	1989	1990	% SHARE 1990
WORLD	**43 831**	**158 289**	**195 153**	**183 835**	**100**
Developed regions/countries	**37 179**	**128 556**	**165 385**	**151 970**	**82**
European Community	14 690	54 278	75 492	88 871	48
Other Western Europe	1 237	3 205	7 086	10 070	5
United States	18 742	59 420	70 560	37 190	20
Japan	325	-520	-1 060	1 760	1
Other developed countries	2 475	8 386	9 027	8 136	4
Developing regions/economies	**12 634**	**29 718**	**29 756**	**31 776**	**17**
Africa	1 411	2 325	4 446	2 196	1
Latin America and the Caribbean	6 035	11 443	8 363	10 055	5
Western Asia	379	690	447	1 004	0,5
East, South and South East Asia	4 644	15 017	16 218	18 328	10
Central and Eastern Europe	17	15	11	89	0,04

Source: WORLD INVESTMENT REPORT, New York, 1992

TABLE 5: INDUSTRIAL SECTORS WITH THE HIGHEST SHARE OF PRODUCTION BY FOREIGN ENTERPRISES (*)

	France (1988)	Germany (1989)	Italy (1989)	U. K. (1989)	USA (1989)	Japan (1989)
1.	Computers 71%	Computers 78%	Computers 63%	Computers 65%	Other manuf. 30%	Chemicals 11%
2.	Chemicals 45%	Chemicals 39%	Electronics 55%	Automobiles 56%	Non-met. products 29%	Machinery/equ. 2%
3.	Electronics 33%	Food, beverages 21%	Chemicals 30%	Chemicals 37%	Chemicals 27%	Basic metals 1%
4.	Non-met. products 27%	Automobiles 20%	Food, beverage 15%	Electronics 30%	Basic metals 22%	Other manuf. 0.6%
5.	Machines 24%	Basic metals 17%	Machines 12%	Basic metals 22%	Electronics 19%	Paper, printing 0.5%

(*) Production from foreign-owned enterprises and enterprises with foreign participation as a share of total production in industry in each country

Source: OECD, Industrial Policy in OECD countries, Annual review 1992

TABLE 6: THE GEOGRAPHICAL DISTRIBUTION OF PARENT MULTINATIONAL CORPORATIONS AND FOREIGN AFFILIATES (Number)

HOST REGION/ ECONOMY	PARENT CORPORATION	FOREIGN AFFILIATES (1)	YEAR
World total (1)	35 000	147 200	1990
Developed countries	30 900	73 400	1989
of which:			
France	2 000	3 671 (2)	1984
Germany	6 984	10 978	1990
Japan	3 331	2 884	1990
Norway	1 115	2 799	1989
Sweden	2 750	......	1986
Switzerland	3 000	......	1992
United Kingdom	1 533	3 411	1981
United States	3 712	13 582	1989
Developing economies	3 800	62 900	1989
of which:			
Brazil	576	7 110	1986
China	553	15 966	1988
Hong Kong	500 (3)	2 464	1982
India	176	926	1988
Malaysia	153	578	1981
Republic of Korea	668	2 821	1988
Taiwan	405	4 764	1988
Central and Eastern Europe	300	10 900	1991
Commonwealth of Independent States	68	2 296	1991
Hungary	66	2 140	1991
Poland	58	2 168	1991
Romania	20	3 527	1991

(1) Represents the number of foreign affiliates as reported by host countries
(2) For 1971
(3) For 1989

Source: UN WORLD INVESTMENT REPORT 1992, New York, 1992

TABLE 7: EMPLOYMENT IN FOREIGN AFFILIATES
(Thousand)

	Japan			Germany			USA		
Subsidiaries in:	1980	1990	Annual growth (%)	1980	1990	Annual growth (%)	1980	1990	Annual growth (%)
Asia	401	484	1,9	133	177	2,9	829	1416	8
North America	82	368	16,2	393	498	2,4			
Canada				914	945	0,5			
Europe	33	127	14,5	711	1100	4,5	2767	2708	-0,3
Rest of world	186	177	-0,5	506	553	0,9	2131	1552	-4,4
World	701	1157	5,1	1743	2328	2,9	6640	6621	-0,04
Manufacturing	605	922	4,3	1312	1638	2,2	4429	4189	-0,8

Source: OECD, Industrial Policy in OECD countries, Annual review 1992

TABLE 8: CROSS-BORDER MERGERS AND ACQUISITIONS MADE IN EUROPE BY ACQUIRING COUNTRY, 1989/90

	1989		Jan-Jun 1990	
ACQUIRING NATIONS	**VALUE (BN ECU)**	**TOTAL NUMBER**	**VALUE (BN ECU)**	**TOTAL NUMBER**
US	13.8	185	5.1	89
EUR12	26.2	768	14.4	458
JAPAN	1.5	54	0.8	26
Rest of the world	3.8	268	10.1	175
TOTAL	**45.3**	**1275**	**30.4**	**748**

	1989		Jan-Jun 1990	
TARGET NATIONS	**VALUE (BN ECU)**	**TOTAL NUMBER**	**VALUE (BN ECU)**	**TOTAL NUMBER**
EUR12	43.9	1148	26.1	672
Other Europe	1.4	127	4.3	76
TOTAL	**45.3**	**1275**	**30.4**	**748**

Source: CEC, Panorama of EC industries, 1991-1992, Luxembourg, 1991

TABLE 9: MERGERS AND MAJORITY ACQUISITIONS IN EC INDUSTRY AND SERVICES (*), 1986-1991

(Number)

	1986/87	1987/88	1988/89	1989/90	1990/91
NUMBER OF OPERATIONS	**220**	**514**	**687**	**947**	**724**
COMMUNITY (1)	57	108	163	237	165
INTERNATIONAL (2)	19	64	75	127	101
TOTAL CROSS-BORDER	**76**	**172**	**238**	**364**	**266**
NATIONAL	144	170	211	219	192

TABLE 10: ACQUISITIONS OF MINORITY HOLDINGS AND JOINT VENTURES IN EC INDUSTRY AND SERVICES (*), 1986-1991

(Number)

	1986/87	1987/88	1988/89	1989/90	1990/91
NUMBER OF OPERATIONS	**428**	**685**	**677**	**900**	**1020**
COMMUNITY (1)	57	104	126	196	332
INTERNATIONAL (2)	78	114	96	153	99
TOTAL CROSS-BORDER	**135**	**218**	**222**	**349**	**431**
NATIONAL	158	249	233	202	158

(*) Distribution, banking and insurance. Data collected from specialist press regarding operations involving the 1000 leading firms in the Community (ranked according to turnover), the 500 largest industrial firms worldwide and the largest firms in the service sector.
(1) Operation of firms from different Member States
(2) Operation of firms from Member States and Third Countries with effects on the Community market

Source: CEC, XXIst Report on Competition Policy 1991, Luxembourg, 1991

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III. PROCEEDINGS

A. PROCEEDINGS OF THE MORNING SESSION

"TOWARDS A GLOBAL ECONOMY?"

DISCUSSION MODERATOR: M. HINDLEY, MEP

Papers:

1. THE EC AND GLOBAL ECONOMIC INTERDEPENDENCE[1]

Professor L. TSOUKALIS, University of Athens, Director of Economic Studies, College of Europe, Bruges

This paper is divided into three main parts: it starts by examining the position of the European Community in the international division of labour; it then continues with a discussion of EC policies aimed at influencing economic exchange with the rest of the world; and it concludes with some observations regarding the main issues facing the Community in the context of an ever growing international economic interdependence and the options available. The discussion about policy options revolves around three main themes: further internal construction (or `deepening' in the Community jargon), regionalism (which also includes further enlargement), and multilateralism.

(i) The EC in the International Division of Labour

With successive enlargements, the EC has become by far the biggest trading bloc in the world, accounting for approximately 20% of world exports, a figure which excludes intra-EC trade. Adding the share of the United States and Japan, we reach almost one-half of total world trade, which is yet another reminder of the dominant position of the Triad in the international economy.

In terms of imports and exports of goods as a percentage of GDP, the openness of the EC as a whole is comparable to that of Japan and the United States; the latter country having registered a substantial and steady increase in its trade openness since the early 1970s (see Figure 1; Annex I). The figures for the EC show considerable fluctuations, especially during the last two decades, which have been largely due to changes in commodity prices and most notably oil. There is, however, no indication of a significant upward trend, even when we exclude energy products from this calculation (see also Commission, 1993a).

Thus, on the basis of the above simple indicator, it appears that the trade openness of the EC has not changed much over a period of thirty years. Is this fact compatible with the growing literature on economic globalization and interdependence? On the one hand, what is true for the EC as a whole is not also true for the individual member countries which have experienced a steady increase in their trade openness due to the increase in intra-EC trade as a percentage of GDP (Table 1; Annex II). This applies to both goods and services. There was a partial reversal of this rising trend during most of the 1970s which was, however, largely compensated by the faster growth of extra-EC trade during the same period. Accession effects, following the enlargements of 1973, 1981, and 1986, have contributed to the growth of intra-EC trade, which now represents approximately 60% of total trade for the average EC country. Trade statistics for individual member countries are still relevant, since many policy instruments, both micro and macro, remain in the hands of national governments.

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[1] This paper draws heavily on Tsoukalis (1993); Bekemans and Tsoukalis (1993). Outi Jääskelainen and John Watson have worked as research assistants for the preparation of the paper.

The strong regional concentration of the external trade of individual member countries of the EC becomes even more pronounced if trade figures with other European countries are added to those of intra-EC trade. Thus, for an average EC country (and this is also broadly true of EFTA members), approximately three-quarters of its total trade takes place within the wider European area (Table 2; Annex III). Regional self-sufficiency is likely to increase further as a result of successive rounds of enlargement of the EC in the future and the progressive liberalization of Central and Eastern European economies.

On the other hand, statistics on merchandise trade are not the only and certainly not the most reliable indicator of interdependence. In recent years, foreign direct investment (FDI) flows have been growing much faster than world trade, leading to a significant restructuring of world production, especially in services and high technology goods (for an extremely useful and comprehensive survey of recent developments, see also Commission, 1993b). This has been the phase of widespread and rapid diffusion of new technologies accompanied by major institutional innovations. Restructuring at the global level also needs to be considered in conjunction with the establishment of wide `networks' and cooperation agreements among firms, covering the whole range from R&D to marketing and distribution. The rapid growth of trade in intermediate products and intra-company trade are also consistent with the trend towards the internationalization of production. A similar, and indeed much more pronounced, trend can be observed with respect to financial markets. And this is directly linked to technological developments and the rapid liberalization of all capital movements. Capital is much more mobile than either goods or labour.

Increasing economic internationalization is an undeniable fact, and there has been a considerable acceleration of this process during the recent period. Yet, references to the `global economy' seem premature and can only be made under poetic license. Political boundaries are still far from being irrelevant, and this also applies to the EC which has reached the highest stage of integration of national economies.

The surge of FDI in the EC during the second half of the previous decade, combined with the wave of mergers and acquisitions, is directly linked to the process of economic restructuring at the world level. But there is also some evidence to suggest the existence of a `1992 effect', in other words the anticipation of a truly unified market in Europe, on investment behaviour and the geographical orientation of the strategic alliances pursued by European firms. The increasing number of cross-border mergers, acquisitions and joint-ventures, together with the ever extending economic `networking' among European firms have characterized the latest phase of European integration which has now gone beyond simple trade; hence a qualitatively different phase of integration. In this respect, intra-European and international developments have been inextricably linked, even though the effect of political initiatives taken at the EC level can by no means be denied.

The big bulk of external EC trade has always been intra-industry trade in manufactured goods, although some important changes have taken place in the position occupied by the EC in the international division of labour over the years. Machinery and transport equipment which accounts for the big bulk of EC exports shows a steadily increasing import penetration. This is particularly true of motor vehicles; but it is also true of several dynamic sectors, with a high technology content and very rapid rates of growth, such as telecommunications equipment, office machines, and data-processing. With respect to those sectors, the decline of the EC export/import ratio has been very rapid indeed. The Community has remained a big net exporter of chemicals and steel; and it has also retained a strong presence in the up-market of relatively weak-demand sectors such as textiles and clothing. Several studies have pointed to the unfavourable pattern of export specialization for the EC, the poor geographical spread because of the heavy reliance on slow-growing economies in the developing world, and the increasing import penetration (Buigues and Goybet, 1989).

Although the above observations are generally true of the EC as a whole, generalizations of this nature conceal enormous differences among the Twelve. The commodity structure of external trade for a country such as Portugal or Greece is closer to that of some developing countries than the commodity structure of Germany's external trade. There are also important differences in terms of the geographical orientation of trade. All these help to explain why member countries have tended to squint in different directions.

(ii) Characteristics of EC Policies

The EC started basically as an incomplete customs union, which meant that the common external tariff constituted the building block of its fledgeling international role. With the gradual deepening of integration, new common instruments have been created, while there has also been a shift in the division of external economic competences between the EC and national institutions. There is a wide range of policy instruments which can be used by political authorities in order to influence cross-border economic exchange. Some of these instruments have long since been transferred to the EC level, while others have remained in the preserved domain of the nation-state. In between, there has always been a wide grey area where the division of power between different levels of authority has been ambiguous but also changing. This is the counterpart of the grey area which exists in terms of internal policies, the boundaries of which are still in the process of being redefined because of the internal market programme; and the same will be true in the future because of EMU.

Are regional integration and international liberalization complementary or competitive objectives? There has never been anything approaching unanimity on this issue in the Community, and the situation is unlikely to change much in the future. Yet, experience seems to suggest that, generally speaking, regional integration in Europe has not taken place at the expense of international liberalization. Trade creation has greatly exceeded trade diversion (agriculture being a notable exception to the rule). Furthermore, a large part of this trade diversion has been compensated by the extra growth generated by regional integration. It can also be argued that the very existence of the EC has contributed to trade liberalization in the context of GATT, partly acting as a catalyst when the Community's trading partners tried to minimize the trade diversion effects arising from internal EC decisions and partly by helping to bring about a shift in the attitudes of member governments.

Early GATT negotiations have contributed to the liberalization of international trade mainly through the reduction of tariff levels and the elimination of quantitative restrictions. But many international trade practices have since developed on the margin or even completely outside GATT legality; and most have figured prominently on the agenda of the Uruguay Round. The EC has had, of course, its fair share of such practices. Thus, the trade liberalism manifested through the low level of its common external tariff needs to be qualified in several respects due to the extensive use of other instruments of external protection (including subsidies, `voluntary export restraint agreements', and anti-dumping) which varies considerably from one sector to another.

There are two broad categories of products subject to relatively high protective barriers in Europe which can be distinguished (Jacquemin and Sapir, 1990), with agriculture perhaps forming a third category of its own. On the one hand, there are labour-intensive products, with low R&D intensity, such as textiles and clothing, footwear and shipbuilding, characterized by growing import penetration by the developing countries. In these cases, international trade is close to the Heckscher-Ohlin paradigm of comparative advantage based on different factor endowments. European protection has been aimed mainly at resisting and/or slowing down the process of adjustment imposed by the loss of comparative advantage.

On the other hand, there are products with high R&D, large economies of scale, and learning curves, such as telecommunications, consumer electronics, and office equipment, where the steady loss of market shares by European producers is mainly due to competition from the United States and Japan. Modern strategic trade theories seem to be more relevant to those products. The new theories of international trade put the emphasis on economies of scale and imperfect competition. Comparative advantage is not seen as given; it is largely created, and governments can play an active role through policies directed at investment, education and R&D. If there is market failure, then the most relevant question to ask is about the probability of government failure (limited information, vulnerability to interest group pressure etc) and the danger of retaliation from other countries. Thus, the answer is no longer clear cut as in the good old days of Ricardo. In the words of Krugman (1987), `free trade is not passé, but it is an idea which has irretrievably lost its innocence. Its status has shifted from optimum to reasonable rule of thumb'.

Multilateralism is a principle that the Americans fought hard to establish as one of the foundations of the post-war international economic order, and the Community has been traditionally one of the worst offenders. In the meantime, the Americans have themselves discovered the virtues of regionalism. Trade preferences have been an integral part of EC commercial policy, and this has led to the construction, in a rather absent-minded manner, of a pyramid of privilege in which different countries or groups of countries occupy successive layers. The Community's privileged partners include EFTA members, the countries of the Mediterranean and the ACP. Since the dismantling of the Soviet empire and the collapse of communist regimes in Central and Eastern Europe, the countries of the region have been progressively climbing up from the bottom of this pyramid of privilege.

Since the 1970s, the Community has made a greater effort to reconcile preferential agreements with Article XXIV of GATT. Such agreements are supposed to cover a `substantial' part of trade, while liberalization should take place within a `reasonable' length of time. Furthermore, the actual economic significance of preferential concessions has been reduced by the lowering of the common external tariff and the adoption of the Generalized Scheme of Preferences (GSP). The distinction between European and non-European countries in the group of the Community's privileged partners has become increasingly clear and relevant in terms of policy. This distinction is linked to the prospect of further enlargement. For the non-European countries, privilege has been increasingly defined in terms of trade concessions without reciprocity and financial assistance.

EC trade preferences cannot be understood in purely economic terms. Keen on making its mark as an international actor and also interested in exerting influence in certain areas, the Community has had to resort to the use of policy instruments which were actually available to it. In other words, trade preferences can be largely explained in terms of the frustration of an economic giant which has remained for long a political dwarf. The wide discrepancy between political objectives and economic instruments at the EC level has provided the foundation stone for the construction of the pyramid of privilege; and even though, perhaps, narrowed, this discrepancy is unlikely to disappear after Maastricht.

Another feature of EC policies is their predominantly defensive and reactive nature; and the contrast with the aggressive unilateralism which sometimes characterizes US policies is quite striking. This has much to do with the high degree of decentralization of the European political system and the wide economic diversity inside the Community. It has been as much true of the role of the EC in successive GATT rounds as it has been of trade preferences and specific sectoral policies.

The link between the internal market programme and the Uruguay Round is quite typical. The White Paper of 1985 was marked by the absence of any serious consideration of the external dimension of the internal market. The European response to the American initiative for a new round of GATT talks was initially entirely defensive. Yet, the fears expressed about `Fortress Europe' have proved unfounded. The implementation of the internal market programme has not led to higher levels of external protection; if anything, it has contributed to further international liberalization, at least in certain areas (e.g., capital movements, banking). On the other hand, had it not been for agriculture, the EC would have appeared as one of the more eager participants of the Uruguay Round.

There is also an interesting comparison which can be drawn between the EC internal market programme and the Uruguay Round. Many items on their respective agendas have been similar; attempts to tackle the multitude of non-tariff barriers and the extension of jurisdiction to new areas and most notably services. The internal market programme has involved a strong element of deregulation, although on this subject the jury is still out. Yet, deregulation has gone hand in hand with new rule setting (frequently based on a combination of minimum common standards at the European level and mutual recognition of national rules and regulations), the development of common policies and the transfer of powers to central institutions; not to mention the strengthening of redistributive instruments (see Structural Funds) intended, among other things, to make liberalization more palatable to the economically weaker members. And all this became possible, even though being the result of long and painful negotiations, because of the considerable similarity of economic and social values, the long history of cooperation, the existence of an elaborate institutional machinery, a well established legal order and common long-term political goals. GATT is hardly comparable, and this fundamental difference is bound to operate as a major constraint on the liberalization process on which the members of GATT have been engaged.

To the extent that there is a fledgeling European policy on industrial structures, the emphasis seems to be on competition policy which applies both to private enterprises and also increasingly to state aids and nationalized firms. Otherwise, public intervention at the European level is mainly directed at the promotion of R&D, especially in high technology sectors, and inter-firm collaboration across national borders. The internal market programme was mainly directed at those sectors in order to enable European firms to take advantage of the economies of scale of a true common market. However, in view of the limited policy instruments available, the relatively scarce financial resources and the weak legitimacy of central institutions, this can only be far short of an activist industrial policy. It will remain instead a very mild version of the old policy of national champions which it has partially replaced. Title XIII of the new Maastricht treaty may suggest an aspiration to move gradually in this direction, but even if such a move does take place, it is likely to happen at a very slow pace. In a world of strategic trade interaction, and assuming that this is a correct description of current economic reality, the EC is bound to remain for long a weak player. But this will be all to the good for free traders.

In terms of sectoral policies, agriculture and steel stand out as the main exceptions of strong interventionism at the EC level. With respect to both sectors, the emphasis has been on defensive policies, including a whole range of measures of external protection, aimed at resisting adjustment. However, some signs of a change in attitudes have appeared in more recent years.

In the macroeconomic field, EC policy has been rather less than the sum of its national parts. Intra-EC cooperation has remained at the intergovernmental level, and this was true even when the EMS was close to a system of fixed exchange rates, with the DM acting as the `anchor' of the system. The Community as such has played until now little role in international policy coordination, to the extent that such coordination has indeed taken place.

(iii) Issues and Policy Options for the Future

The major challenge for the EC in the foreseeable future will be how to reconcile the objective of further internal construction, closely linked to wider political goals, with its role and responsibilities as a regional and international power. And it will certainly not be an easy task. The wide discrepancy between economic and political integration, which can be presented in different terms as the uneasy coexistence of an increasingly European and international economic reality with national political units, could act as an important constraining factor on further economic integration. On the other hand, the persistence of high unemployment rates and growing economic inequality in European societies will make the task of building a political and social consensus behind new liberalization measures at the Community level even more difficult.

At the same time, the EC is faced with the prospect of a never ending process of enlargement, since virtually every European country is now aspiring to full membership. Even if most of those countries may have to remain in the waiting room for many years to come, with some new status of associate membership, the Community will still need to improve considerably market access for their exports, often directly competing with those of the economically weaker countries and regions of the EC, and also undertake the biggest burden of financial aid for those same countries. True, trade liberalization may be in the long term beneficial for all European countries concerned. But as long as there is no significant improvement of the macroeconomic environment and unemployment remains at socially dangerous levels, public attention is likely to focus on the short-term adjustment costs.

With the exception of a few politically stable and economically prosperous countries, most of whom are anyway expected to join the Community sooner rather than later, the whole of the Community's immediate neighbourhood is unlikely to be a model of stability in the foreseeable future; and this is clearly meant as an understatement. This applies not only to Central and Eastern Europe but even more so to most countries in the Mediterranean where demographic growth, economic stagnation, and Islam can produce a very explosive mixture. And the large waves of immigrants should be expected to swell further.

Serious internal problems in the Community and perceived threats from the East and the South could therefore lead to much introspection and impotence at the international level. This is a real risk. Yet, the EC cannot shut itself off from international markets nor can it ignore the effects of increasing economic interdependence at the world level. As the European experience very clearly shows, liberalization cannot proceed much further without joint rule-setting and common management. This applies to FDI but also to economic regulation relating to consumer and environmental protection, not to mention different forms of government intervention intended very clearly to influence the allocation of resources and which are often lumped together in this strange category called non-tariff barriers (which are supposed to be abolished altogether?).

As a major international economic actor, the EC has a clear interest in the development of common rules and the strengthening of international institutions for the more effective management of interdependence, even though experience would suggest that it is mainly the less powerful members of any system who need most clearly defined rules and supranational methods of dispute settlement. However, this first-best approach, based on the principle of multi-lateralism, cannot assume away the real difficulties and constraints which often exist in reaching meaningful agreements at the world level. The experience of GATT and the Uruguay Round in particular is a good example.

The EC has a strong interest in the successful conclusion of this (never ending?) round of trade negotiations and the further strengthening of multilateral cooperation, including most notably the creation of a Multilateral Trade Organisation with some real powers. Yet, to expect agreement on the basis of anything more than a very low common denominator on important issues and policy areas, such as competition policy, may be to expect too much. Could the members of the Triad undertake a joint leadership role in this respect? On the other hand, bilateral (see the EC-US agreement on competition policy) and regional arrangements are not always incompatible with a long-term multilateral goal.

In the macroeconomic field, the efforts at policy coordination have been concentrated within a small group of highly industrialized countries (G-7); and the results have not been brilliant. Coordination has been sporadic and it has worked only when all major players happened to share the same interests. It has focussed on exchange rate coordination, with some occasional coordination of monetary policies and virtually no coordination of fiscal policies. Incompatible analytical frameworks and strong domestic political constraints have constituted the main obstacles to a more effective international policy coordination. The proposal made by President Delors for the creation of an Economic Security Council at the UN level may be a useful one; but as long as no great expectations about quick and concrete results are attached to it.

It is sometimes argued that the creation of EMU and hence the replacement of an uncoordinated musical group of Twelve by a single and stronger European voice in international fora should lead to a more effective coordination of macroeconomic policies at the international level. This expectation may be not only illusory, but also dangerous. The high degree of decentralization of the emerging European political system will add to the constraints on effective policy coordination. In a future EMU, the President of the ECB should be able to speak on behalf of the Community with respect to monetary policy; but what about fiscal policy? The problems experienced by US Administrations in the past in terms of being able to commit themselves and eventually deliver the goods in international policy coordination will pale into insignificance compared with those to be faced by Community representatives in the future.

The policy conclusion is simple: multilateral cooperation and joint management yes, but as long as expectations and policies take sufficient account of the political pluralism and the economic diversity which characterize the international system. And this is not necessarily a defeatist conclusion. In certain cases, bilateralism and regionalism may be second- or third-best solutions. As for the Community, its ability to play an effective role as a regional and international power will largely depend on the strengthening of its own political system, the creation of the necessary conditions for sustainable economic growth and the development of policy instruments which can promote internal adjustment.

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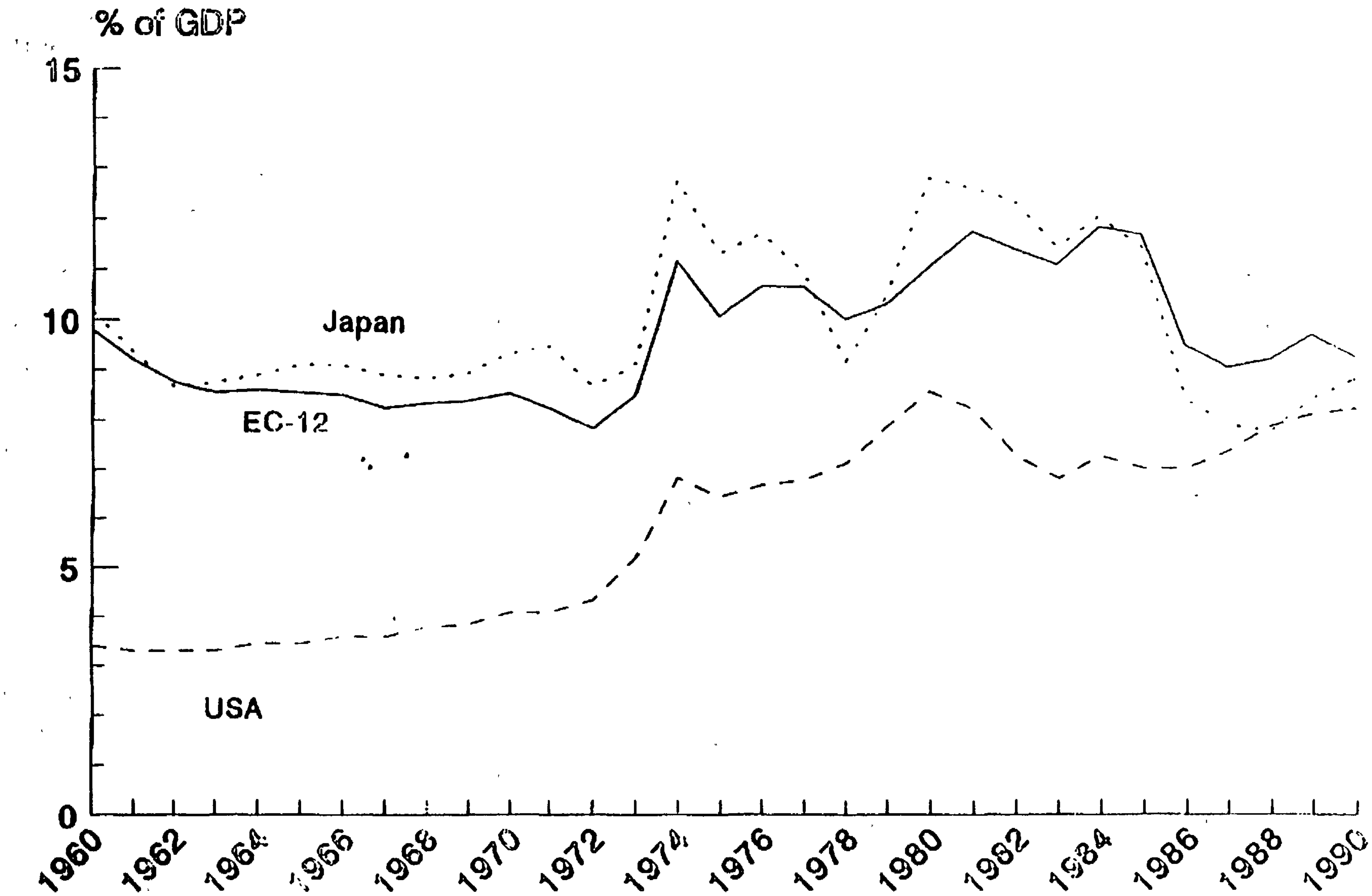

Fig. 1. Exports and Imports of Goods of EC-12, USA, and Japan, 1960-1990
(sum of exports and imports divided by 2, % of GDP)
Source: Tsoukalis, L.: The New European Economy, OUP 1993. Based on data from Eurostat and OECD.

Table 1. Openness of EC Economies, 1960-1990
(average of imports and exports of goods as a percentage of GDP;* intra-EC trade is given as a % of total trade)

	1960-1967		1968-1972		1973-1979		1980-1984		1985-1990	
	World	Intra-EC	World	Intra-EC	World	Intra-EC	World	Intra-EC	World	Intra-EC
Belgium and Luxembourg	37.5	64.8	42.8	71.2	48.9	71.2	61.5	67.0	60.8	71.7
Denmark	27.0	52.3	23.4	46.7	25.3	48.2	29.1	49.1	26.7	50.8
Germany	15.9	44.8	17.6	50.9	20.4	50.3	24.8	50.5	24.9	53.1
Greece	12.7	50.6	12.7	53.4	17.6	47.3	19.5	48.1	20.8	60.5
Spain	8.1	47.8	9.2	44.4	11.2	41.3	14.4	39.3	14.4	56.0
France	11.0	45.8	12.5	57.2	16.6	55.0	18.9	53.9	18.6	61.9
Ireland	33.6	72.2	35.3	71.6	45.8	74.3	50.1	73.1	52.0	72.2
Italy	11.7	42.9	13.1	49.5	18.4	48.7	19.4	46.1	18.9	55.0
Netherlands	37.7	62.7	36.4	67.8	40.6	65.9	47.8	64.1	49.0	67.8
Portugal	19.8	48.3	20.3	49.6	22.2	50.2	30.1	50.1	32.5	65.1
United Kingdom	16.0	26.7	16.7	31.2	22.3	37.9	21.6	44.1	21.0	49.9
EC-12	8.8	45.0	8.3	51.9	10.2	52.6	11.5	52.2	9.8	59.8

* Figures for world trade as a % of GDP have been calculated by inserting country data for imports and exports of goods (SITC categories 0-9) in the

formula: $$\frac{\frac{1}{2}\sum (x+m)}{GDP} \times 100$$

For the Member States, these figures include intra-Community trade; for EC-12, intra-Community trade has been excluded.

Source: Tsoukalis, L.: The New European Economy. Second Revised Edition. Oxford University Press 1993
Calculations are based on data from Eurostat.

2. EUROPEAN INTERNATIONAL ECONOMIC POLICY ISSUES

Professor R. DORNBUSCH, Massachusetts Institute of Technology, Cambridge (Mass.)

The dominant fact in Europe is mass unemployment; the accomplishments of four decades of integration, and specifically the brilliant 1992 strategy, have lost their shine. A good portion of the electorate wants to put Europe on hold, or on ice, and instead pursue narrow national interest policies. This comes at the very poor time. The world economy ios stagnating; worse, with communism gone transatlantic partnership has lost in apparent importance. That view, of course, is dangerously wrong. There are important tasks in world economic management that need cooperation and that should not be sacrificed to parochial issues at the national level. I shall bring the following arguments:

- The narrow European Community, even augmented with a sprinkling of Scandinavia, is an anachronism. Widening to the East, early and fully, is far more important than carrying forward the 100% integration scheme which seemed plausible a few years ago and is now on the rocks.

- The world trade system urgently needs attention. Sustaining GATT and pushing forward with the Uruguay Round is essential if a relapse into world protectionism is to be avoided. The fuse is short, both in Europe and in the United States. Bad news on the progress in world trade negotiations would quickly take a toll in assert markets and would also bring to the surface the latent and not the latent call for protectionism in many places.

- Bilateral trade liberalization is a powerful way to enhance the scope for trade in goods and services far beyond what can be accomplished in the framework of GATT. Europe and the United States should open discussions on a sweeping North Atlantic Free Trade Agreement.

- There is a need for a better worldwide mechanism of regulation of an increasing range of services and for dispute settlement. A World Trade Organization with a strong charter and substantial leadership would be an asset for the world economy.

- A priority and challenge in world trade is to integrate India and China as they open their economies and seek markets. These economies are too large and too important to be treated as run of the mill newcomers.

- EMU has become an obstacle to prosperity; reenacting stubbornly the 1930s only serves to create even more unemployment and reaps no benefit; in fact, it even gives integration a bad name.

- The notion of introducing capital controls in support of unviable economic policies is an extraordinary retrogression for a modern market economy. Developing countries are routinely advised to dismantle at the earliest convenience such mechanisms; it would be surprising if they were found useful and productive for modern, open economies and societies. A good policy is a financial transactions tax, but that cannot work except when applied by all major economies.

- A new international monetary system is not a good idea. The independent pursuit of monetary and fiscal policy, except for occasional coincidence of purpose, makes fixed rates impossible. There is some room for de facto, broad target zones. Little else is worth doing to contain exchange rate movements in the North Atlantic Area.

- Japan's continued closed markets are the most blatant violation of the open world trade system. The United States and Europe should collaborate in opening Japan or else in impose a major penalty for violation of the rules of the game.

  A major appreciation of Asian currencies, not only of the Yen, is appropriate so as to shift these economies from export-led to a more domestically centered growth.

(i) What Concept of Europe?

One Europe? Yes, but going far to the East. The urgent part is the East - not Italy with its unacceptable puberty pains, not Portugal, Greece or Spain feasting at the transfer trough, not the idiosyncrasies of a Brussels bureaucracy that has proven unable to redefine priorities in the face of the most dramatic shift of needs and priorities. The end of communism reminds us what the game is all about - peace and prosperity, that is how Franco-German cooperation started - and this is where Europe must start afresh. There needs to be an alternative to Germany filling the vacuum. Maastricht is not coming on; Franco-German cooperation is the next best alternative. But even that is hard to get. Focus on the East is the essential priority.

People in Poland or the Czech Republic, and increasingly in Russia do think of themselves as European and they want their claim recognized. The two-speed strategy of carrying the West to full economic and political integration whole the East is left pout in the cold cannot but breed instability and ultimately bad European politics. Anyone who is concerned to contain Germany against an expanding tole in the east must focus on the East becoming an early partner rather than a problem.

With European mass unemployment, integrating the East is a hard challenge. But if this does not become the central European task, Eastern Europe will become a major trouble region. Economic progress is <u>not</u> being made on the requisite scale, investment will not pour into the region and the consequence will inevitably be bad economics, bad politics, migration and instability.

Spain, Portugal, and Greece were brought into the EC to stabilize their economies and open their societies. The same argument applies to the East today. The existing time table makes less than appropriate concessions to the genuine need for fast and vast action.

(ii) World Trade at the Cross Roads

The final stretch is opening up for the world trade policy race. The Uruguay Round, as every year, has its "last" chance of passing or going on the rocks. Except, this time the stakes are much higher; if we fail, there may not be an easy extension since in the U.S. authority for trade negotiations expires and may not be sought or renewed in a way that makes life easier for reaching a compromise. Moreover, NAFTA is about to go to Congress and is about as popular as the Chinese flu. If NAFTA and/or GATT fail, there is genuine trouble for the status quo. All the more reason for Europe and the United States to reaffirm our confidence in an open trading system and to recognize the stakes. World stock markets will go into a nose dive if trade negotiations fail!

Everywhere jobs are at the very top of the agenda and the support for free trade falls far short of unanimity. Organized labor wants protection and there is a risk that the politicians may go along, at least part of the way. In some countries, notably France, nobody even bothers to make excuses for protectionism; its simply called the "national interest".

For many observers free trade has become suspect - the benefits seem less obvious because are too many instances where market access abroad is impeded one way or another: landing rights for our airlines, lack of access to public tender in Europe, unfair competition in the aircraft market,a closed Japan, etc. Even our managed trade deals are not coming off as planned and promised. If the benefits seem limited, the costs of an open trading system are blatantly apparent. Jobs all too easily go offshore and labor markets opened to world competition have gone soft.

Even if free trade is suspect, of the options we have it still remains the one that best suits the national interest. Free trade needs no apologies; by contrast, protection is an irresponsible flirtation with a threat to prosperity and international security. The end of communism has weakened the cohesion of our international system and poor economic performance everywhere has added to fragility. Ambiguity in the U.S. trade policy stance could all too easily sweep in pessimism and a slide towards trade conflict and the same is true in Europe. Our exports are there only as long as our trading partners can earn their way to pay for them. If world trade is shut down, as it was in the 1930s, everybody stands to loose.

Is there not a third way, in between free trade that "does not work" and the 1930s that nobody wants to bring back? Can't we increase the range for managed trade where markets are split up among contenders, each gets their share, and that is the end of the game? We should be suspicious that some of our most interventionist trading partners - France and Japan most prominently - actively favour such an approach. The world and each partner does best in an open, competitive atmosphere and we should shy away from static, interventionist deals that limit the scope for our expansion in the years to come.

Europe and the United States should now assert unequivocally their commitment to an open trading posture. The Uruguay Round works on a multilateral basis to open new areas of increasing interest to Europe and the United States, including intellectual property and services and to start bringing some rationality to world agriculture. The existing blue print, although rushed in shortly before midnight last year, goes far to meet our interests. With proper amendments to offer more liberalization and to retain the option of US trade sanctions, it is another important stepping stone on the way to free trade. Against the background of a firm and demonstrated resolve to pursue an open trading system, trading partners can and should then take a very assertive stand in all those areas where today our rights and interests are infringed.

Soon we have to cope with the integration of post-communist economies, India, and China into the world trade system. Billions of people who today live in basically closed economies will over the next decade try and participate in the world trading system. We can't keep them out, at least not without major security risks. Better to create a good, open system before this wave crashes fragile resolve and weak institutions. We can chose to do things well or poorly, but we cannot escape from the reality that what happens next door and around the globe has a direct impact on our standard of living. No country, not even Europe or the United States, can pretend it is an island onto itself. We have interests around the world and can prosper best by spreading our way of doing business.

(iii) North Atlantic Free Trade

Europe's focus on 1992 and on building a politically integrated region and, at the same time, the U.S. focus on domestic problems, has detracted attention from cooperative possibilities. There are compelling reasons to move a North Atlantic Free Trade Agreement. Excepting minor areas of friction, both Europe and the United States view North Atlantic trade as a two-way street. Both regions accept broadly the idea of competition and of openness. Why not make a virtue of it and open up fully. Specifically, with high tech trade and trade in soft goods becoming more important, why not move a Europe style agenda for North Atlantic trade.

One objection might be that until Europe is complete, further trade moves with the outside threaten the progress on the inside. It might be argued that there is already too much restructuring and competition so that it would be unwise to overload the boat. Of course, the counter argument is that one might as well make the full adjustment to a more open economy rather than moving in stages that need not go in the same direction.

A more important argument in support of he position is political. There is a great need to reestablish a sense of common purpose between Europe and the United States. Building Europe should not become an anti-Us move; after all, the U.S. has always been in the front line of support for an integrating Europe (doubtful comments about the EMS notwithstanding). A fresh wave of economic integration will broaden the market, unify the regulatory framework,m enhance members' international cost competitiveness and create a center of gravity that is more nearly ale to compete with the emerging Asian economies.

(iv) World Trade Organization

Beyond the Uruguay Round, the world economy needs a cleaner set off rules and regulations than is available today. Trade is spreading to areas that are not at all regulated nor are they open at present. Dispute settlement is too arbitrary, including as an extreme the U.S. super 301. A fresh approach is o create a central institution that promotes the free and frictionless functioning of world trade. GATT has been very good for the expanding of world trade; now a further step would help in taking the institutional setting for world trade a large step forward.

Industrial policy, competition policy, and regulation are issues on the agenda everywhere. But they do not or at least should not have national answers. Finding international answers, standards and procedures will make for less friction and less waste in the world economy. A World Trade Organization would be the answer.

(v) EMS?

In the ERM straitjacket, the European economy in 1993 was lost to recession and 1994 is unlikely to see recovery. European unemployment, already at 22 million, was expected to rise in 1994 to an all-time high. The demise of the narrow ERM now opens the door to far better performance in most economies. It is entirely wrong to believe that something precious was lost last week-end; on the contrary, the liberation of currencies previously trapped in the ERM offers a major opportunity to recapture the buoyant spirit that animated Europe in the run-up to 1992.

The decision to loosen exchange margins was inevitable; central banks could postpone, within limits and at escalating cost, the time of a crisis, but not the ultimate occurrence. The markets understood the basic dilemma. The Bundesbank had made clear its unwillingness to cut interest rates to preserve the existing exchange rates. Whatever the rhetoric, Denmark, Spain, Belgium and ultimately France lacked the reserves and the resolve to sustain exchange rates at the price of visibly and rapidly rising unemployment. Uncertainty about the timing and extent of German interest rate cuts and the urgent need for relief in the distressed partner countries opened up a credibility gap. Such a situation always is a standing invitation for speculators who understand which way rates must move.

Sometimes currency speculation may deserve the bad name it has; by prematurely hardening exchange rates, the central bankers and finance ministers of Europe gave speculators the proverbial one-way rise. Even so, in this case the speculators were the best friend of the unemployed, and - even though we will not hear that admission - of the monetary officials who had assumed unsustainable commitments. There has undoubtedly been some loss of face for officials who proclaimed that they would never devalue, but it would be wrong to dwell on that; rather than look back and dream of punishing speculators, officials need now to exploit the newfound freedom to fight unemployment, of course paying due respect to inflation risks.

The decision to maintain the format of the ERM - exchange rate margins, but 15% - is sound and pragmatic. The EMS was a good convergence device for quite a while but it hardened prematurely with the insistence that further realignments would destroy the accumulated gain in credibility. Countries like France or Belgium and Spain did not want to throw away their crutches. With narrow margins and no realignments, the room for divergent interest rate developments vanished just at the time when the high German inflation made far more flexibility highly desirable. Everyone had conceived the EMS as a disciplining device for lax Latinos; ironically now it became the victim of an immensely inflationary Germany. The wide margins adopted in the present form can accommodate major divergences in interest rates without the prospect of creating yet another crisis, or at least not soon.

What strategies should countries pursue to use enlarged scope for interest rates and currency movements? There is no common and simple answer for each of the countries gaining freedom of maneuver. All most be concerned to avoid a recurrence of inflation, a task more easy for some than for others. But they also must give urgent priority to expansion because that is the only way to bring down unemployment. Low interest rates are the fastest affordable way, given actual or imagined constraints to fiscal action, to get there. Finally, they all must look beyond recovery to give more emphasis to the supply side: more room for incentives, more flexibility, less status quo. But beyond these general common targets, the differences in constraints and opportunities deserve spelling out.

France enjoys a privileged position for action. With moderate inflation, France can go hard for growth and will succeed. France should cut interest rates rapidly to reach a level of 4 to 5 percent in just a few months. There is no reason to hold off. In fact, given the long lags of monetary policy in stimulating recovery - particularly when unaided by fiscal stimulus, as the United States demonstrates so clearly - there is no place for complacency. Even with immediate action, it will take at least to the beginning of 1994 to see results in terms of growth.

In the case of Belgium the need for moderate interest rates is even more imperative. The extraordinarily high debt ratio - perhaps the highest in the world - makes the country hypersensitive to even the appearance of unsustainable strategies. The country has a good reputation now, but it can lose it in no time if interest rates stay high.

Spain faces far more serious constraints. Inflation is not moderate and the instinctive response to a weakening of the currency is a resurgence of inflation. Of course, keeping the tight money lid on does not solve the problem. Lower interest rates are essential, growth is paramount, the status quo of pervasive corporatism, lack of competition and mounting unemployment needs a co-operative, frontal attack.

That there is another way is demonstrated by Switzerland, Italy and the United Kingdom. Switzerland has interest rates below 5 percent, far below those of Germany. The United Kingdom when it was pushed out of the ERM last fall opted for growth and is well on the way, without signs of strain or loss of financial stability. Italy's demise at the hands of speculators became the foundation for growth and for domestic far-reaching domestic reform. Italy's case demonstrates that unions can be farsighted and willing to cooperate in a growth strategy that does not translate into inflation.

Interest rate cuts cannot be accomplished without some depreciation of currencies. Only with the expectation of an appreciation relative to the DM can a currency have lower interest rates than Germany. The practical question then is how much, say, the French Franc must decline to support moderate interest rates. The necessary depreciation is very limited, perhaps 5-7 percent. After all, France would just be moving ahead of German rate cuts by 6-12 months or so and that hardly warrants major swings. In the case of Belgium and Denmark much the same argument applies. Thus the extent of depreciation need not be large and stabilizing speculation can be counted on to limit the fall.

There is, of course, a strong argument for limiting unnecessary volatility and uncertainty by broadly and informally coordinating the strategy among the floaters. For interest rate cuts they can travel together for much of the way and that will limit excess volatility. Where they part company will depend on their attitude toward unemployment, their performance on inflation, and their success in bringing down rates without overly large depreciation.

If interest rate targeting takes advantage of the newly gained room for letting exchange rates move and growth resume, there is also the question of when to tighten the margins and return to the EMU project. The immediate priority is flexibility and that precludes formal commitments to unsustainable exchange rate targets. There is no reason, however, to rule out pragmatic trading ranges around newly found levels of the exchange rate, once interest rate cuts have taken place. Thus we do not expect major volatility, just because the margins are wide. Ultimately, 18 months or 2 years from now, Europeans can reexamine whether the preconditions for stable rates or even monetary union are in place, how to remedy shortcomings, how to assure better coordination, and who to proceed.

Whether one day there is a common money or not, a common Europe has already shown its worth in the establishment of a market where goods and services flow freely; the good name of Europe will be all the better if further integration yields prosperity and not mass unemployment.

(vi) Capital Controls?

The idea that capital controls should have a come back in Europe is very disturbing. (Financial Times Sept. 19, 1993). Capital controls are immensely cumbersome and mostly ineffective. A monetary "fortress Europe" is an anachronism and a major intrusion in the efficient operation of markets. The enemy is not the speculator but the central banker with the wrong priorities.

Good economics combines a financial transactions tax which penalizes short-horizon trading with a very substantial enhancement of the profitability of long-term investments. The financial transactions tax penalizes heavily short-run trading but puts virtually zero penalty on the long-term profitability of investment. The reason is that payment of a 2.5 per mil tax on a ten year investment represents a negligible fraction of the principal and earnings but on an overnight round trip it would eat up the profits except on the hottest tips. With this tax, the hurdle rate required to warrant short-term transactions is inversely related to the holding period. A one-night stand would require an annualized rate of return of more than 500 percent to just pay the tax. For a half-year round trip the hurdle rate is down to less than 100 percent and for a 3 year investment the burden falls to less than one-twentieth of a percent. Clearly the tax is not an obstacle to long term investment. Investors will look for assets that promise serious returns in the long term, not for a way to get overnight returns from the negative-sum game of volatility. Predictably, the round-trip industry will disappear, and good riddance!

The scheme is in the best tradition of the Chicago School. The economy needs a favorable environment for capital accumulation. The unreasonable treatment of equity and long term investment has taken us to a point where every morning investors look out of the window to see whether America is still there. Debt burdens encouraged by the tax laws already impair the Fed's ability to conduct a noninflationary monetary policy. CEOs of nonfinancial businesses divide their time between litigation and speculation, rather than focussing on investment in research, development of technology, products and markets. Capitalism blossoms when business takes the long view, unimpeded by insecurity of property rights or financial fragility. We have managed to undermine capitalism's blessings by turning financial markets overly trigger-happy by an emphasis on debt-leverage and the short horizon.

Keynes in the General Theory offers a description of the difference between "speculation" which is geared to making capital gains from uncovering the shifting psychological moods of the market versus "enterprise" which seeks to earn income from the long-term holding of an asset. He notes the markets' pursuit of short-term capital gains rather than long-term holding yields:

"When capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done. The measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment into the most profitable channels in terms of future yield, cannot be claimed as one of the outstanding triumphs of *laissez-faire* capitalism - which is not surprising, if I am right in thinking that the best brains of Wall Street have been in fact directed towards a different object."

Keynes concludes with the recommendation for "a substantial transfer tax on all transactions... to mitigate the dominance of speculation over enterprise in the United States." That advice of 1934 is even more appropriate today. In fact, nobel laureate James Tobin has advocated a variant of this scheme to curb excessive zest for speculation in international capital markets. In Tobin's scheme a tax on international currency purchases should "throw some sand in the wheels" of international financial markets. Others have gone further to argue that if sand is not enough, use rocks.

Why interfere with short-horizon speculation? Financial market participants must know what is best for them. Who is to double-guess that their individual profit maximization does not also lead to the best social use of resources? The short-run focus creates an externality in the form of excessive liquidity. An analogy helps build the case. Most sane people agree that gun control is desirable because an uncomfortably large number of people do carry guns. Whatever they may be maximizing, it surely is not social welfare. Gun control disarms an overly trigger-happy world, just as speed limits cool off overly aggressive driving. Liquidity is of the same nature; it cries out for a tax that curbs the excess. We all want to be totally liquid, all the time; yet the economy's capital must be held. Too sharp a focus on the short run means that the capital stock will adjust; there will be little and what there is will be short lived and not the most productive.

If most trading takes a short focus, most actors in the economy cannot but follow the same pattern. If everybody speaks loudly we have to shout to be heard, if everybody carries revolvers, we have to carry submachine guns to be safe. And if everybody trades by the minute, we have to trade by the second to get ahead. The economy converges to a bad equilibrium, far away from the productivity of capital, totally focused on the minute capital gains. Nobody stops us from taking the long view but that would be a lonely life made far more precarious by the high volatility created by the market's short horizon. Excess liquidity produces an abnormal and counterproductive shortening of the economy's horizon; it spreads from financial markets to corporate suites and the shop floor. It has corrupted America's ability to compete in the world market and it urgently needs redress.

Gun control would not stop all murder; poison and knives would make a come back. And speed limits have not done away with traffic accidents. A financial transactions tax will not stop speculation altogether. But it certainly will help lengthen the horizon and focus the mind of capital markets on enterprise, and on investment, rather than trading.

Opponents of a financial transactions tax will be quick to point out that it cannot work. Business will simply move offshore, to the islands where catering to tax evasion is already the chief industry. True, some trading would move offshore. The risk is easily exaggerated and in any event it can be checked. Switzerland, for example, has a financial transactions tax and that seems not to have done away with its status as a financial center. Moreover, why not seek international agreement on a world tax since the disease is clearly spreading.

(vii) Asian Appreciation

Over the past two decades and more, Asia has been enjoying an extraordinary growth experience. A virtuous cycle of high rates of investment and innovation, high growth rates of output and real wages, and high rates of saving combined with macroeconomic stability yielded record growth rates almost without interruption. And that process keeps going on. Japan's recession is but a momentary setback in a picture of stunning growth.

Table 1 Asian Economic Growth

	1971-80	1981-90	1991-93
Asian Nics	9.0	8.8	6.9
S.E. AsIa	7.7	5.5	6.7
China	7.9	10.1	9.2
Japan	4.5	4.2	2.7

Source: Asian Development Bank and IMF

Widening access to the world market and a dynamic export sector have been key factors in the growth record of these economies. For at least a decade. large trade surpluses have also been part of the story. By way of envy or just curiosity, the question arises whether the performance unduly benefited from export-led growth, at the expense of the rest of the world. Specifically, of the many explanations for Asia's surpluses, has systematic currency undervaluation been an important factor? And if so, is there likely to be a correction soon? We will argue that the answer to both questions is affirmative.

Asia has been running surpluses with the world for more than a decade. Moreover, bilateral surpluses with the United States have been growing. On preliminary indications the 1992 numbers, which are not yet available, promise to show record levels.

- Asia's surpluses have received a number of explanations:

- Asia saves at a high rate, the rest of the world and specifically the United States does not.

- Asia has surpluses because the playing field is tilted in their favour.

Evidence in support of this view includes the very closed nature of the Japanese economy. In other industrialized countries import penetration has doubled or tripled, in Japan it has barely moved from a minimal level.

Table 2 Japan's Imports
(Percent of GDP)

	Non-Oil	Manufactures
1961-70	7.9	2.0[a]
1971-80	7.2	2.1
1981-90	6.4	2.4
1991	5.9	2.9
1992	n.a.	2.6[b]

[a]1965-70 [b]1991:4 to 1992:3

If Japan is closed, the same cannot be said of all Asian economies. Some have practice outright openness. Others, such as Korea have gradually opened but reached in the process a very remarkable level of exposure to world competition. For example, In Korea non-oil imports corresponded in 1991 to 26.5 percent of GDP.

- Quality, marketing, and service have also drawn attention as a separate explanation.

- A further explanation should occupy a central place: exchange rates. Over the past decades Asia has been catching up with the United States. That catchup process should ultimately translate into significant currency appreciation, but that has not yet happened. In fact, with the exception of Japan, Asian currencies today are at their 1980 levels or even more competitive then at the time. And even for Japan the moderate real appreciation in no way offsets the enormous gain in market position of the past few decades. Unchecked by appreciation, the gains in manufacturing performance translate directly into export-led growth and trade surpluses.

Table 3 Real Exchange Rates in Manufacturing
(Index 1980-82=100, data show July 1993)

Japan	139.2	Malaysia	85.8
Taiwan	87.3	Thailand	78.8
Hongkong	123.3	Indonesia	56.2
Singapore	88.1	Philippines	92.9
Korea	74.1		

Source: Morgan Guaranty

There are three reasons to expect a major appreciation of Asian currencies. First, in the current situation of world weakness the evergrowing Japanese surplus is an offense.

The second reason for appreciation is less immediate but as important. Asia is experiencing a unification project just as occurred in Germany. Coastal China, Vietnam, North Korea and Siberia are moving toward the market. Asia money, capital goods technology, management, and market outlets are the engines of that process. As this process goes forward, Asia's advanced economies from Hongkong to Taiwan, Korea and Japan will run trade surplus with the transition economies and they will be financed by direct foreign investment flows and portfolio capital.

The increased trade will in time create a boom in the advanced economies. As that boom comes, just as in Germany, real appreciation is inevitable. That can come in one of two ways: domestic inflation or currency appreciation. The preferred way, of course, is a rise in all the Asian currencies in unison relative to Europe and the dollar. The reason to take this prospect seriously is not only the fact that it is already underway. More so, it is the sheer size of this transition region - far larger in fact than Eastern Europe and the former Soviet Union. China is already the second largest economy and, at the growth rates we are seeing today, it won't take much time for the giant to be #1.

The third reason for Asian appreciation is to be found in Europe and the United States where fiscal tightening is underway. The phase-in assures that the economy has a chance to adjust to the budget cuts without recession, but what is the adjustment? Lower longterm interest rates will help increase investment and a far lower dollar and European currencies relative to Asia will turn around external trade. While there may be some dollar depreciation relative to Europe or the other way round, the brunt of our gain in competitiveness will have to be relative to Asia. We need trade surpluses, they can shift their surpluses to the Asian transformation economies. A major currency appreciation will help make that adjustment smoothly.

Sceptics will ask: can exchange rates do the trick? Where is the evidence that a stronger Yen will mean smaller Japanese surpluses? In the past, major changes in the Yen have not had a stark impact on Japan's trade? An important reason was the way Japanese companies operate. Rather than rapidly adjusting prices (and hence the trade balance) the companies would pursue their long term strategies even at a loss. Their captive financial institutions would finance the long horizon strategies. Today the financial system is on the ropes. They can no longer accommodate a extended adjustment to a tight exchange rate situation. Accordingly, Japanese firms would be forced to work more with prices and that is precisely what one expects in the aftermath of currency realignments.

That leaves one more question: how to accomplish the move in the Yen? To accomplish a major Asian appreciation is in the first place a political decision. Countries such as Hongkong who peg the dollar would have to move just as much as Japan where the exchange rate is closely managed by the authorities. A good move on the Yen could come about if Europe and the United States made it known that just this is their agenda for the next summit.

A major currency realignment such as the one discussed here is not without precedent. During the postwar period Europe enjoyed export-led growth, taking advantage of an increasingly undervalued currency. Germany (like Japan today) had occasional and minor realignments, but the group held on to an undervalued currency despite repeated U.S. appeals. Only with the transition to floating in the early 1970s was the situation rectified with a 30 percent U.S. depreciation. Just the same is necessary now in our currency relations with all of Asia.

Attention rightly focuses on opening up Japan, but the cumbersome diplomacy focuses on only one instrument, the administrative piecemeal opening of one sector or another. Because there is a lot of work to be done in breaking down Japan's closed economy, we should use all tools available for the task. It would be a mistake to forget that currency depreciation can render sweeping assistance in that effort. Moreover, adjustment is as important for all of Asia as it is merely for Japan. One more reason there to use a broad and sweeping currency appreciation.

(viii) What To Do About Japan?

Japan goes through the motions of participating in world affairs. But missing is the commitment to help build a better world; Japan just stands by and waits to be told how much to pay and what is the bare minimum with which to get by. Japan has strangely been unable to find its way into the world community; it has lacked great leaders who shaped by the trauma of war might have helped build an open world economy where economic nationalism would not be again a cause of war. Japan has no strong links to a world system which it did not help build, and it has made few friends. Herein lies the risk of serious conflict.

Four decades of trade liberalization notwithstanding, the Japanese markets for manufactures, for services and for agriculture remain virtually closed. Manufactures cannot make their way into Japan, except when produced by Japanese firms abroad. The difficulty of access has nothing to do with special economic conditions of the Japanese economy nor with the shoddiness of foreign goods. It reflects a culture determinedly opposed to trade as a two-way street. That attitude is increasingly challenged by Europe and the United States. It is becoming more and more likely that it will lead to a major trade conflict.

In merchandise trade and in services it is exceptionally hard for European, U.S. or Asian firms to break into the Japanese market. Firms that have cultivated the market for a long time do sell and, because margins are extremely high, enjoy a profitable business. But successful firms ares outnumbered 100:1 by those who have not been able to make it even if they try hard by international standards.

The episodes are more than telling. Security firms that ultimately manage to cut through bureaucracy and get registered in Tokyo, find their bond issues boycotted. Manufactures find it impossible to cut through the complexities of trade access. Service firms find it impossible to compete in public tender. The game is rigged and it takes an age to make headway. By then Japanese competitors have in place the technology, innovation, or financial product that a foreign firm was trying to introduce.

Of course, there are messages to the contrary. Successful foreign firms operating in Japan sing an "all-is-well" chorus which is not really persuasive. We are told that US firms are making profits in Japan. What is surprising about this? US firms make profits everywhere; what is suspect is the need to even assert it. In fact, the very profitability of these firms has probably more to do with the closed Japanese markets where margins are phenomenal than with the achievements of the chosen few firms who have gained access.

Japan tells us that most problems lie abroad: US budget deficits and the poor quality of American goods. Or else, that Japan is not closed but must export manufactures goods to compensate for its lack of natural resources. Finally, that Japan may have been closed in the past but liberalization is underway by leaps and bounds. These arguments either miss the point or run counter to the facts. The mechanisms that close Japan to outsiders are not clear - neither tariffs nor quotas play a role - but by any definition Japan is closed.

Manufacturing Import Penetration. By this measure Japan is far out compared to other industrial countries. In Europe the ratio is more than 10 percent of GNP. Even the United States, a far larger country, has still twice the Japanese import penetration ratio.

Table 4 Import Penetration in Manufacturing

	Consumption Share		GNP Share	
	1975	1985	1980	1989
Canada	19.5	38.7	14.0	18.8
Germany	22.9	31.7	12.0	15.6
UK	14.2	33.2	13.2	17.9
US	5.5	12.9	4.5	7.1
Japan	4.7	5.3	2.4	3.1

Note: The data refer to manufacturing.
Source: OECD "The OECD Compatible Trade and Production Data Base: 1970-85". Paris, mimeo, 1988. GATT and IMF

Korea's import penetration in manufacturing is 18.7 percent - six times that of Japan. Of course, Korea is a developing country and hence the ratio might be high for that reason. But this would suggest that Japan might have had a high penetration ratio in the past. In Japan manufacturing imports have moved between 1.5 and 3 percent of GNP, without much change for a quarter of a century.

GATT rounds of trade liberalization and major swings in exchange rates have done almost nothing to change Japan's openness. This evidence supports the view that Japanese protection is like an onion; it has multiple layers like an onion and the inner most are cultural, not the conventional restrictions in the form of quotas or tariffs.

Considering next the entire range of non-oil imports, the Figure represents a dramatic portrait of Japan's situation. While Germany's import penetration increased steadily, that of Japan actually declined over the past 3 decades.

Intra-Industry Trade. In open, developed economies consumers have the advantage of choosing from a broad range of product qualities and varieties produced throughout the world. Given the diversity of consumer tastes and the specialization of firms, any country would both import and export consumer goods or capital goods in many categories. Intra-industry or two-way trade is the common experience of advanced countries.

The extent to which countries do pursue two-way trade is readily measured by an index which assumes a value of 1 when trade is completely two-way, i.e., in a particular commodity group imports equals exports. The index reported in the Table 5 assumes a value of zero when trade is a one-way street.

Table 5 Intra-Industry Trade in Selected Manufactures
(Index: One Way=0, Two-Way =1)

Category	Germany	S.Korea	Japan
Finished Manufactures	.72	.72	.33
Machinery & Transp. Equip't.	.66	.94	.25
Elect. Mach. & Apparatus	.89	.68	.27
Automotive Products	.71	.91	.17
Textiles	.90	.33	.36

Source: GATT International Trade

All three countries are resource poor. Korea and Japan have their geography and transport costs to the West in common; Korea is poor while Japan and Germany are rich. Whichever way we look at these data, Japan is severely closed to intra-industry trade. Any story of resource endowments, geographic location or the state of development simply fails.

In Japan protection is at work, by invisible hand. There is no other explanation for a value of intra-industry trade of finished manufactures in Japan of 0.33 versus 0.72 for each, Korea and Germany. A good specific example is automotive products. Germany does have superior products and even so has intra-industry trade with a two-way index at 0.71 In Japan the corresponding number is an entirely absurd 0.17.

Japan does not practice two-way trade. Manufactured goods are produced and exported, they are rarely imported. To some extent resource endowments influence the index: clearly, a country without natural resources will be a net exporter of manufactures to pay for oil imports. Yet, the puzzle is this: why does Japan look so different from Germany? Germany does not have natural resources anymore than Japan. Do Japanese consumers, unlike consumers everywhere else in the world, not like imports? Or are they still taught to save foreign exchange and favor home industry as might have been plausible in the immediate postwar period? Or are there mechanisms we cannot see that plainly keep imports out? The skyrocketing of imports when liberalization does occur lends weight to this last hypothesis.

Radical, rapid and complete opening of the Japanese market is now a must. But it is not enough for Japan just to start catching up with other countries. Moving too late and too little means a path straight to trade conflict and beyond.

Japan must make a real and determined effort to become a leading, active part of the world system. Japan must recognize that there are two ways to go. Either the country participates in a system of common goals and common responsibilities where the largest countries drive the initiatives and bear the burdens, or else Japan divides the world and builds its new Asian empire, based on confrontation and hostility to the West.

Dissatisfaction in America with its own performance and rising populism in response to the middle class squeeze will make America increasingly antagonistic. Therefore the state of limbo cannot last; Japan should be nudged to act.

In the 1930s, access to markets and access to raw materials were the issue and with ineffective sanctions the aggressors drifted toward war. Just as in the 1930s, there are no plausible sanctions against large countries who do not play by the rules of the game. Unless Japan looks at the 1930s, at the arrogance of Pearl Harbor and the tragedy of Hiroshima, the country once again puts itself at odds with the world. The time is particularly appropriate for a major initiative: Europe is opening to the East to stem the tide of migration, the United States is opening to Latin America. Japan needs to open to the world.

Japan has grown up and is looking to define a role commensurate with her economic strength. It is as well to trigger the search for that identity and let Japan choose whether she is willing to be part of an open trading system or look for another role. We are ambivalent about Japan, fearful of Japan bashing and uncertain about triggering trade conflict. Japan is conscious of our lack of resolve and exploits it to the fullest. Where we go wrong is in assuming that a showdown can and should be avoided.

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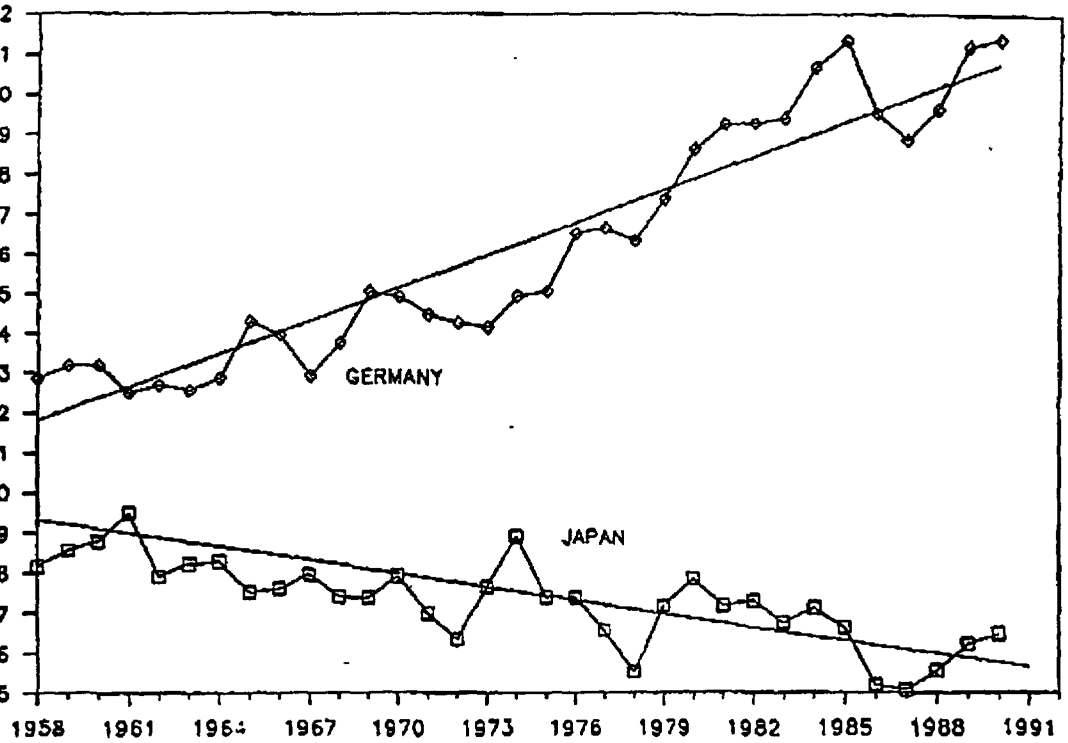
NON-OIL IMPORTS AS PERCENT OF GNP



Main speakers in the debate:

1. ***Mr ALBERT, Executive Chairman of Assurances Générales de France, Paris***

Mr Chairman, I am in a position of weakness as I have not had the time to read the papers which I found upon my arrival. My comments will therefore have to be somewhat off-the-cuff, but this is possible as we have just heard two speeches which were each, in their own way, excellent.

If I may reply to you, Professor DORNBUSCH, who, as we all know, has the gift of being provocative - with this gift, Professor, I think that you could make a career in the media and, indeed, you have perhaps already begun to do so. This gift is due to the fact that you have, first and foremost, an overall world vision. You have a very wide-ranging and enquiring mind, which is particularly alive to two facts. The first is the need for a new way of thinking to ensure that China and India are now integrated into the international economy. I believe that there is a danger of us being slow to realize this. I also believe that you are right to say that Western Europe and North America have many problems in common and that it is important that an in-depth agreement should be reached between these two regions. I agree with that, particularly as we face many problems.

Another important point is that free trade is even more of a thorny issue given that we are facing a period of recession. You are quite right on that point and it is clear that a great deal is at stake in the Uruguay Round.

However, we should not forget that major social and political problems in many countries are tied up with the problems of international trade.

I was impressed by a book which has just been published in Belgium by a leading Belgian figure, André Leysen, entitled 'Le Retournement' (Reversal). I was intrigued to see that, in the opinion of this former Chairman of the Belgian Employers' Federation, this reversal is now related to the problem we are discussing. Leysen begins by quoting the figures presented by Jacques Delors in Copenhagen showing how the Community's share of international trade has decreased over the last 20 years and, more especially, showing the European Community's ineffectiveness when it comes to creating jobs. Leysen goes on to say that, in order to remain within the world sphere of interdependence, the Belgians must radically modify their social welfare system.

I do not need to tell you that this is set to become a highly topical issue and perhaps not only in Belgium. So I come back to my point that you spoke about world organization and not only about world trade. I think that we must bear in mind that the subjects we are discussing are not merely trade transactions and that social and political aspects underlie these subjects.

This leads me, Professor DORNBUSCH, to admit that I was shocked to hear you say that Europe is an anachronism. This is a phrase often used by the media but it could not be more inaccurate. The only benefit it may have is to help provide us with what we lack most in Europe, namely, stimulants. By the very sharpness of your criticism you may have a stimulating effect upon us. But, for example, when you say that the European Monetary System is an obstacle to development, I find it hard to agree with you for at least two reasons.

The first is that, since the EMS upheavals, (September 1992 and 1 August 1993), nearly all businesses in the European Community have been obliged to take out exchange cover, which clearly constitutes not only an extra expense but also an obstacle to the preparation of projects and investments. The more we look at the medium- and long-term, the more the lack of a stable exchange rate system becomes a handicap for two-thirds or three-quarters of trade. In other words, failing a European monetary system, we will not have a single market. We will have an incomplete market which will be volatile and separated out into its component parts. This is one of the reasons why I truly believe that we must not treat this subject lightly.

I also wonder whether you are not going a little too far when you put all the Asian currencies into the same category. You say that the Asian currencies should be revalued by around 30%, but it seems to me that a little more of a distinction should be made with regard to certain countries, such as South Korea, Malaysia and Indonesia, which are running a current account deficit.

These comments lead me on to tell you why, on the other hand, I agree wholeheartedly with Professor TSOUKALIS. I think that he was right to emphasize that we are, as has been said, an economic giant and a political dwarf, but an economic giant in the process of breaking up; if we do not get organized, in the monetary field first of all and then, as rapidly as possible, in the sphere of political union, we shall cease to be an economic giant and I fear that we might even revert to being a quarrelsome entity. You have shown how our European experience was truly an example for the building of a better world because we were able not only to improve trade amongst ourselves at regional level but also to open up to the world outside.

I should like to draw attention to two experiences in the past which were highly significant. In the first place, let us suppose, Mr Chairman, that we never had the Treaty of Rome, the European Community or a common external trade policy. Let us suppose, for example, that instead of having had a negotiator for 30 years or more in international bodies and, in particular, the GATT, we had had 12 negotiators. Do you not believe that the addition of 12 countries - all different from one another - in the negotiations would have imposed far more obstacles than those same countries united by their single negotiator? This is at least one reason why Europe is not an anachronism.

And I would add that the processes by which European integration began are worthy of consideration today. As you know, European integration began with the ECSC (European Coal and Steel Community) Treaty. As you also know, shortly after the entry into force of the ECSC Treaty, we witnessed a structural crisis in the coal industry and a slower crisis, although also a structural one, in the steel industry. At that moment, Professor, we in Europe had the organization which was most characteristic of all the Community undertakings, namely, on the one hand, the desire to open up competition, with competition law prevailing within the European Community and, at the same time, methods of financial and social intervention which ensured that the developments were not too drastic or too intolerable in social and political terms. The experience of the ECSC initially and the European Customs Union subsequently gave us an appreciation of what transition entails, it fostered in us the art of taking into consideration the fact that the economy does not consist solely of goods or transactions but also of human beings, families and cultures. Today, rather than forgetting the value of this experience at a time when, for example, we are seeing so many drastic redundancies in the motor industry, we must remember that the European Community certainly accomplished its task with regard to international economic integration in a wise manner which deserves to be not only extended but also imitated. Thank you Mr Chairman.

2. *G. SINCLAIR, Deputy Permanent Secretary of Sistema, Económico Latinoamericano (SELA), Caracas (Venezuela)*

Let me begin with the paper of Prof. TSOUKALIS. I would like to congratulate him very sincerely for what seems to us to be a truly excellent document. It is a thorough, accurate and thoughtful assessment of the role of the European Community in the global economy. It describes well the changes taken place in that Community and the reasons why the Community has to change, particularly changing trends towards greater emphasis on intra-european self-sufficiency. The analysis suggests quite rightly that there is likely to be a readier spread of economic activity: production, trade flows, commercial cooperation within the region than on a global level. His treatment of EC policies highlights two areas that are of special interest to Latin America and the Caribbean, both the areas of low technology production such as clothing and footwear and that of agriculture have been the focus of continued discussion if not disagreement within the Community. His argument, that there has been a reluctance on the part of the Community to agree to dismantle protective mechanisms coincides with our own contention in Latin America and the Caribbean. I will, therefore, not take issue with you on that.

There is a very important conclusion in the section on policy options which holds a lesson for observers of european integration as well as for those who are striving towards achieving integration. That is the need to reconcile future internal construction, whether widening or deepening, with the role and responsibilities of the integration body within the region and internationally.

Some more general observations, one relating to the question of definition: He did say that it was not correct to speak right now of a global economy. I agree with this view because there is a lack of the necessary structure, mechanisms and rules to allow us to speak of the true existence of a global economy. But I think we need to be careful whether we use economic internationalisation and economic interdependence interchangably. For me the concept of interdependence connotes a level of mutuality of impact or of effect; effect or impact that is not necessarily symmetrical; often it is asymmetrical; it is not necessarily mutual either; it is often not mutual. There is certainly a widening of production processes and economic interactions. It is debatable to what extent that constitutes mutual impact, or worse, mutual benefit. It seems that what we used to call transnationalisation or cross-frontier activities are being used as a synonym for interdependence. There is a subtle but important difference.

I would like to raise now one perspective of the EC and what that body signifies to the outside world: How we in Latin America and the Carribbean see the EEC. The EEC is a whole: to a large extent it is a unified group but in another real sense the EC is also the sum of its parts. The paper of Prof. TSOUKALIS addresses very well the functioning of the whole: less well I suggest, does it address the functioning of the disaggregated parts of the Community. If we are to look at the G-7 for example, we see that there are four EC Member states participating, plus the Members of the Commission. To some extent it is correct to say that these members participate in the G-7 in an individual capacity representing their individual countries. But I think it is naive to believe that these countries do not to some extent reflect a common European perception that is bred of the EC experience and, therefore, reflective of shared objectives among the Community. In other words, we all see the four contributions as Community perspectives. The point I am making is that the EC does have a presence and an impact in the world quite outside that manifested by its formal institutional manifestations. That presence lies in the voices of its individual members particularly for us in Latin America and the Caribbean as heard in the pronouncements of the G-7. I would contend that in order to determine fully the role of the EC in global economic interdependence we have to examine the roles of its individual Member states and see how they contribute to interdependence and the extent to which those states represent common or allied positions which might then be representative of the Community.

Another general feature which will demand further examination is the impact of internal developments on the outside world. The paper does great justice to internal developments as constraints to or inputs in EC common policy. Those developments are part of a dynamic economic process whose effects extend well beyond the confines of the EC into other regions of the world such as Latin America and the Caribbean. A clear example of this is the Uruguay Round negotiations.

Finally if we were to transfer the basic premise of the analysis from the EC to the global level then the prospects for global economic interdependence do seem quite daunting. What the European experience demonstrates is the difficulty of reconciling disparate political objectives and authorities as well as economic inequalities among the Twelve. That reality suggests that the achievement of joint management and rule setting at a global level which economic interdependence would seem to require, is extremely difficult except under the undesirable condition of the imposition of wills by the powerful. I am not very certain of the effectiveness or the usefulness of an Economic Security Council. I think, in this regard we are ad idem. But once again, I think that is a truly superb study.

Now if I may turn to Prof. DORNBUSCH's paper I would also like to congratulate him very sincerely. I think that as a macro-economic study this approach is a very brilliant and a very thourough one. But looking at this from the prospective of the Latin American Economic System we would have liked to see some geopolitical, some real world considerations introduced there. The paper says that for Europe the focus on the East is an essential priority. It does recognise that integrating the East is going to be the hard challenge and I am not necessarily disagreeing with this. But we would have liked to see some attempt at least at tracing the dimensions of that challenge. And we are looking at these states against the background of recent experience in the case of Germany. That experience was dramatic and traumatic. What we saw on CNN did not necessarily represent the feelings of the majority of Germans, but it represents the feeling of a minority of Germans. Nevertheless there were some important negative manifestations and the process of opening towards the East will have to take account of similar feelings in Germany and in other countries of Europe. What it shows is that in the context of Europe's current unemployment and recession, opening to the East is a process on which individual governments will have to take bold and hard internal decisions. All because of the consideration, as he said himself, of national interest. Such opening is going to be viewed by all Western European states in the scale of national interest. Each one is going to be putting in place its own attempts at limiting what he considers to be the damaging effects of opening to the East.

This makes me think, therefore, that to the extent that it is possible to identify a first priority and a second priority, that first priority might be trying to put Europe's economic house in order. I think, when that is done opening to the East becomes altogether a more manageable and less formidable undertaking.

With regard to the Uruguay Round, we in our region do not believe that it is enough simply to reaffirm confidence in an open trading system as is called for in the paper of Prof. DORNBUSCH. We have no doubt that Europe believes in such a system. The problem is that in our perspective seen from down-South Europe is preaching one thing and practising something else. We would like to see more uniformity between what is preached and what is practised.

My next point regards interdependence and I return to this very important point which I started in connection with the address by Prof. TSOUKALIS. Prof. DORNBUSCH says that what happens next door and around the globe has a direct impact on our standard of living. That is very clear and well said, but I think even that is an understatement. Interdependence is not so easy for us to grasp, though it is everywhere around us. One dimension of it we see in the role of CNN, which is bringing to the peoples of the developing world in the South images of the oppulence that exists in Europe. And as Alfred SAUVY said, if capital does not flow to where the people are, the people will flow to where the capital is. So I think of the impact that CNN, for example, is having on the developing world, in relation to reinforcing the contrasts between opulence on the one hand and poverty on the other. I think the environment also shows the effect of interdependence. What do environmental abuses in the South do to agriculture in Europe? Here we see a very clear manifestation of interdependence. The paper undoubtedly recognises that the security and the prosperity of Europe are inextricably bound with the security and prosperity of regions beyond Europe, with the economic progress of the South, and in my own case, of Latin America and of the Caribbean. We believe that following on from such a recognition should be a set of corresponding policies based on partnership.

The paper recognises clearly that there is a pressure from the East but there seems to be a less clear recognition of pressure from the South: from the developing part of the world. In a real sense, therefore, any consideration of Europe and of its future security has to take account of the present and future security of Third World countries. In responding to this our policy should not be simply to wait and deal with the manifestations of these effects of interdependence when they come to our borders, but rather to put in place a number of policies which would try to mitigate those effects even in the places where they are taking place. And these policies should consist, I suggest, first in assisting Third World governments to resume a course of economic growth through increased resource flows and through international trade liberalisation in the North, and secondly through stabilisation of the international economy at a level and in a manner which takes account of the interests of developing countries.

My last point has to do with capital controls. We agree with the very sensible views expressed by Prof. DORNBUSCH. The experience of the Latin American and the Caribbean region certainly underscores the great risk inherent in speculative capital which can go just as quickly as it comes. States of Latin America and the Caribbean have had various types of capital controls for different reasons. In our region, in the 70's till the mid-eighties the popular consideration was that of channelling domestic savings towards local investment and preserving selected sectors from foreign investment. This was in accordance with the development strategy enforced at that time which accorded a predominant role to the government. Those sectors which were considered priority benefitted from soft financing while governments themselves used these resources to cover budget deficits or to subsidise state agencies. Often the results were disastrous. But whatever the successes or the failures of these attempts the entire situation began to change in the context of our policies of reform of the role of the state, the deterioration of our terms of trade and the decline in external financing. The controls which had been effective for the development of certain industries could no longer make up for the weaknesses of the internal financial market.

While the kinds of controls initially introduced and the reasons for introducing them were convenient to all countries developed as well as developing, and also the theoretical framework is that which the World Bank or the IMF had defined the experience of each government was different. It is therefore difficult to predict what is going to be the effect of the imposition or the lifting of any kind of control on the movement of capital into or out of the country. What is more, experience in our region shows that there is no automatic relationship between modifying the external investment regime and attracting foreign investment or the repatriation of capital.

The challenge for governments is to determine what controls to impose or to lift, and their timing, and to assess what would be the short and long term effects of their decisions.

3. ***H. CHO, Chairman of the Board of NARA Corporation, Seoul***

Thank you for your kind introduction. At the outset I would like to express my gratitude to the European Parliament and to the Chairman DE CLERCQ of the Committee on External Economic Relations and distinguished friends for inviting me to this very important Public Hearing on Economic Interdependence in Brussels. Indeed, it is my real pleasure and honour to be part of this forum. I come here with no provocative thoughts nor with results of great theoretical analysis: but, I come with a hard opinion of the strictly private sector from Asian region. One more excuse: the two excellent papers by the two distinguished speakers, Professors TSOUKALIS and DORNBUSCH, did reach me, but 24 hours before my departure to Brussels. Fortunately, I have been able to read them during the flight.

First, I will make some general statements on the implications of economic interdependence on the Asian region or on the subject matter of this Public Hearing, and then, I will continue with some specific comments on the papers presented by the speakers.

With end of World War II, the countries which adopted the free trade system under GATT and IMF financial and monetary systems were able to register sustained rates of economic growth. The Asian economies, particularly East-Asian economies and today China coming later, were the principal beneficiaries of such an economic order. Nevertheless, the concept of non-discrimination which is the central principle of GATT began to be challenged especially by:

- accelerated structural transformations in the world economy,
- enhanced economic competition and,
- the rise of economic regionalism.

With the global free trade system at the cross-roads the Asian economic order seems to be also at a critical phase. There are two opposing forces determining the direction: one by the necessity to form a region-wide Pacific Economic Community given the enormity of the size and the high level of intra-regional interdependence. Capitalising on these trans-pacific trends, institutions such as PBEC, PECC and APEC, have been established. They all aim to strengthen trans-Pacific ties, the catch phrase being "open regionalism". However, the current economic trends in the region do not necessarily favour a trans-Pacific region-wide community. The trends concurrently show the political potential to divide the region into several sub-regional groupings or free-trade areas, like NAFTA, AFTA and CER.

Yet, a free trade area concept is by nature only a second best option after "free-trade" itself and possesses an intrinsic danger of becoming inward-looking. Let us look at the NAFTA for a moment. We believe in the assurances given by NAFTA that NAFTA:

- will not become a custom's union,
- will not have a common currency nor a common economic policy,
- will remain as an open-ended mechanism.

Nevertheless, NAFTA is an evolving process and it may disrupt the trans-Pacific linkage by inward-looking potential challenge and future direction of expansion which will inevitably provoke a similar reaction by East Asian countries.

Today with the sole exception of North Korea, all the nations in the Asian region have integrated, or are in the process of integrating their economies with the dynamic growth of the Pacific Basin. The destiny of Asia will be outward looking and Pacific-oriented. From an East Asian perspective, the option of forming an East Asian economic bloc may not simply be possible for the region's future development. Thus, Asia seems to have only two realistic options:

- strengthening the global free-trade region,
- reinforcing the trans-Pacific connection.

Fortunately, these two options are complementary.

Economic Interdependence may act as an ivisible hand to temper nationalistic sentiments of individual countries and guide it towards the common good of the whole region. The solution to problems such as:

- economic polarisation,
- enhanced competition,
- the rise of economic regionalism,

will be to increase the interdependence among regional economies which, I think, can best be achieved by entrepreneurship and individual initiatives. I am hopeful that a newly emerging global economy by virtue of deepening interdependence will see:

- explosion in the development of technologies,
- rapid exchange of information,
- cross-border manufacturing systems.

This completes my opening statement on implications of economic interdependence in Asian region. Now, I would like to go briefly through the papers presented by the speakers.

In the Orient, there is an old saying that "At Mr Kim's dinner party Mr Lee is not supposed to make a long dinner-speech." I know, I am at the European Arena. However, in as much as we are discussing international economic interdependence, I would like to have seen some comments or a reference by Professors TSOUKALIS and DORNBUSCH, in their papers on the very important process which is taking place in Asia-Pacific region today. I am referring to APEC process. President CLINTON surprised the Asia in July with his proposal for a summit of leaders from the 15 members of the APEC forum. In other words, APEC process is going from ministerial to summit level. The United States is taking the chairmanship of APEC this year and is exhibiting certain leadership. And we all know that Japan is going through a political readjustment process and trade imbalance problem in the region with Japan is not small. Stronger US leadership and initiative for APEC process are probably more welcome at this time, particularly in countries like Australia and Korea. We believe that APEC process also is likely to weaken any Asian regionalism. The Atlantic Community draws together the US and European powers. Asian is far more diverse, but the need for trans-regional links would mean a greater urgency as the pace of geo-political and economic change quickens in the Asia-Pacific region. Economic cooperation through APEC provides a common basis to build up trans-regional links.

On the Asian prospective for the Uruguay Round, we must work towards a succesful Uruguay Round. This has been said before. However, the key issues in the UR have to be settled between the United States and the European Community. Asia can continue to grow even if the UR fails, but at a slower pace and with far more stresses and strains. There is no good substitute for GATT. Asia can do more in terms of market access in areas like rice and services. The successful Uruguay Round is the single most significant way in which the world leaders could reaffirm their commitments to multilateralism and do us all some economic good at the same time.

Prof. DORNBUSCH has mentioned the integration of China, Japan, Indochina, India and the Middle East. In the longer term China's impact could be even more significant than that of Japan. With its huge population and resource base, China, no doubt, will become an economic force. China is today an important regional power with growing global influence. US deficit with China would rise 30% to 24 billion US Dollars in 1993 and might soon overtake the deficit figure with Japan. China-Japan relations are the key relationship in the Asia Pacifc region today after US-Japan relations.

Prof. DORNBUSCH has contributed several pages on US-Japan relations and also the deficit problem with Japan. The United States is a significant partner in Asia. US diplomatic, military and economic power and presence are very strong. Asia needs to find ways:

- of promoting peace and stability,
- to build up mutual confidence and,
- to resolve conflicts of interests in the region.

This means healthy bilateral relations with the United States and opening of the market, particularly that of Japan, to prevent the American domestic pressures for managed trade building up. After all, Asia needs an outward looking self-confident United States with a robust economy.

An appreciation of Asian currency has been mentioned by Prof. DORNBUSCH. I would agree on this issue with Monsieur ALBERT's comments made earlier. The countries like Korea, Malaysia and Indonesia are still in deep deficit situations. We do have chronic trade deficit problems with Japan. Therefore, I am not sure what an appreciation really can do. In fact, this year, Korean WON has depreciated 5 %. This is by market force.

This will conclude my discussion at this time. Thank you to you all and Mr Chairman indeed.

Concluding remarks of the morning session:

ECONOMIC INTERDEPENDENCE
Mr Michael HINDLEY, MEP

First of all, a previous speaker was quite right to remind us that if we are to have a global economy, it must be a global economy which takes into account the needs of all the countries and all the economies. I am always surprised when I hear people talk about a global economy being something new. I say that as someone who is brought up in a small textile town in Lancashire which for 200 years has traded with the world. The money which startet up the Lancashire textile industry had been made on the sugar plantations in the West Indies which were in turn financed by the slave trade. It was money made by British investment abroad which launched the industrial revolution. Cotton is not grown in my country and all the cotton which the Lancashire weavers used had to be imported; at the "high-watermark" mark of the Lancashire textile industry, some 80 % of its production, was for export. Therefore It all comes a bit of a shock to me as a Lancastrian to hear people say that there is something new about a global economy.

What, I think, has changed, is simply that more countries, more economies had been drawn into the world economy. Secondly that as more countries had been drawn into a slow but sure spread of democracy more countries have wanted to have a say in the formulation of that world economy. What has also changed very significantly in recent years, has been the spread of new technology and the concurrent tremendous speeding up of the ability of capital to move around. That is clearly new. People are quite right to warn that the rules for a global economy must not be seen as being rules drawn up by those dominating that world economy at the present time. I remind everyone of the reluctance of many developing countries to come to the GATT Round in 1986. That reluctance, I think, grows. I certainly think that we have a huge problem in Europe and North America to convince the rest of the world to stay on board with GATT and to avoid the growing suspicion that there is an attempt to sew up world trade and world trade agreements in the interest of those already in a dominating position. This suspicion is particularly strong in Asia where there is a feeling that those who are the top powers at the moment are not only drawing up the rules but further that those top powers, Europe and the USA, are not only in a recession but may be in permanent decline. There is some feeling of apprehension that world rules are being drawn up to save and safeguard the position of declining economies.

A previous speaker said that Europe is "an anachronism". He is right to raise the question whether the EC in its present form is an anachronism. Clearly great things have been achieved in the EC and the lessons drawn from that integrating process should not be lost. But the essential point is that Europe itself is changing. Fortunately for history, things still go on chronologically. The year 1989 when Eastern Europe blew up happily came before 1992 when the EC market was integrated. It is very pleasing to me, and a salutary lesson for dreamers and planners, to remember that history still happens day by day, year by year. We can come unstuck if we try to impose a pattern on events which then is overtaken by events themselves. 1989 has been the significant change in Europe and that impact will spread throughout the rest of the world. It does not mean to say we should tear up all that has happened before 1989 but surely it brings into question whether we can continue on the same basis as we had done before 1989. As someone who has always pleaded for a wider Europe, I have always been vexed and annoyed about the way the EC has annexed the title "Europe" for itself.

Two further points : the question has been raised by all the speakers about the interplay between foreign policy and trade policy. Within the nation states there has always been an interaction. They use trade policy to promote foreign policy issues and foreign policy issues are clearly influenced by trading matters. But there is no such equation in the European Community. The European Community has an undisputed competence in the field of drawing up trade agreements on behalf of Member states, but has scarcely any competence when it comes to foreign policy. This is a disequilibrium in the EC which, I think, will always mean that - to use one of the clichés going round - the EC is doomed to play the role of an economic giant and a political pygmy.

Finally I am very struck as, I am sure, everybody else is by the pragmatic terms of participants' contributions so far. I think it is very important to proceed on the basis of what is happening rather than on the basis of what we would like to be happening. The critisism we have heard this morning on the problems with the exchange rate mechanism goes to the heart of the matter. If you wanted to integrate 12 countries economically and financially in Western Europe you would not have chosen the 12 countries which are actually Members of the EC. So the idea of monetary union, I think, is correct. Whether it is the right idea for the current members of the EC is another question.

That brings me to the need to be more flexible. I would not like us to be hedged into the present allegiances which we have, thinking here is something called Europe, there is something called North America and there something called Asia which are monolithic blocks in competition. There is a nice coincidence that NAFTA can mean North America Free Trade Area just as well as North Atlantic Free Trade Area. And I throw the question out of this stage that there is some sense in looking at the North American Free Trade Area. It may be yet easier to integrate and give a framework to the obvious economic interdependence which does exist between North America and Western Europe, than, for example, that which may exist in any foreseeable future between the EC and the rest of Europe. I am grateful for the contributions so far in having brought an element of pragmatism to the debate on economics which is often lacking among those of us who are embedded in this warm and complacent institution, the European Parliament.

III. PROCEEDINGS

B. PROCEEDINGS OF THE AFTERNOON SESSION

"A NEW APPROACH TO ECONOMIC MANAGEMENT"

DISCUSSION MODERATOR. M.A. FERNÁNDEZ ORDOÑEZ

PRESIDENT OF THE TRIBUNAL OF DEFENCE OF COMPETITION, MADRID

Speech:

INTERNATIONAL ECONOMIC RELATIONS AND GLOBAL MARKETS
The Rt Hon Sir Leon BRITTAN QC, Vice-President of the Commission of the European Communities for External Economic Relations

(i) Introduction

I would like to congratulate Willy De Clercq and the Committee on External Relations of the E.P. on having the far-sightedness to organise this conference.

It is not easy for us all to take time for study of longer term trends in the shape of the world, when there seems to be crisis all around us. But it is vitally important that we do so. I am pleased to be here, and want to set in its political context the detailed policy paper on interdependence submitted by the Commission services for this event.

Europe is going through a rough patch. In such times, it is all too tempting to argue that we have first and foremost to set our own economies on the path of recovery and sustained economic growth, confronting the challenges lying beyond our borders only as a second priority.

Such reactions of panic and introversion would be as dangerous today as they were in the 1930s. Perhaps more so. Because, to be blunt, in the new world ec onomic order, national interest in the old sense is the wrong objective and the national policy tools of the past will in any case not permit the pursuit of national interest.

Global interdependence makes worldwide cooperation not merely desirable but the only workable means of facing our domestic as well as international difficulties. Our economic prosperity, as well as peace and stability in the rest of Europe and the rest of the world, depend on our understanding the changes that interdependence has brought and adapting our activities to take advantage of those changes.

(ii) Economic Globalisation : 4 Key Changes

The international economic landscape today is radically changed, both geographically and in structure.

- The levels of trade and the sort of product traded, have changed beyond recognition. Intra-firm trade and trade in semi-manufactures are the dominant activities in the goods secotr, while trade in services and goods together now equal fully 40% of GDP.

- The focus of world growth has broadened. It has shifted from the Transatlantic economy to encompass Asia.

- Foreign investment is no longer the exception, certainly among developed and perhaps soon among some developing countries.

- The world financial market has taken the place of national markets, easing world liquidity but reducing each individual country's macroeconomic independence.

(a) Trade

Levels of trade today are higher than ever. Merchandise trade now represents 16% of world GDP. If trade in services is included, the corresponding figure is around 20% compared to 11% in 1963. Even more significant are the changes in the composition of trade. Trade in manufactured products today accounts for over 70% of merchandise trade, compared to around 50% thirty years ago. Moreover, a growing percentage of this trade is in intermediate manufactured products. For the major industrial economies, intermediate manufactured products make up as much as 50-70% of their imports. And for some major economies, anything up to 50% of exports and 30% of imports take place within multinational companies.

(b) Asia

The shape of the world is changing too. Today, the Asia-Pacific region has the highest growth rate in the world in spite of world recession.

- By the end of this decade, trade in the Asian-Pacific area will exceed trade within Europe.
- Across Asia, output per person is doubling every 10 years. Savings rates run at over 30% of GDP. Asian banks hold more than 1/3 of the world foreign currency reserves.
- Between now and the end of the century the number of people aged between 20 and 40 will decline in the US. It will decline in Japan. It will decline in Europe. But in the Asia-Pacific it will increase by some 80 million, representing a huge advance in productive capacity and buying power.

These figures promise a dramatic transformation, far outstripping the Asian miracle that has already brought most of us to realise that Asia is the continent of the next century. We realise it, but how quickly are we reacting to this new reality ?

(c) Foreign Investment

The growth of intra-company trade reflects the substantial direct stake we have in each other's economy. Foreign direct investment in the last decade has grown three times faster than trade and four times faster than world gross domestic product. The global stock of FDI is estimated to amount to ($ 1.7 trillion) 8.5% of world GDP. It is no exaggeration to say that foreign investment has fuelled much of the growth which occurred in the Eighties.

Most of this foreign direct investment still occurs among the industrialised countries. But the newly industrialised economies of Asia, in particular, are making rapid headway as outward investors. They account for most of the sevenfold increase in outward investment from the developing world that we have seen over the last few years. This outflow is directed both towards the industrialised world and towards other countries in their region. Although outward investment from these countries remains low, they represent a mere 3%

of the total, we can expect to see the development of increasingly complex flows of FDI in the future.

(d) Financial Markets

Technological advances in informatics and communications have permitted the development of instantaneous, 24-hour trading in currencies and financial assets across the world. The following figures are eloquent. Turnover of foreign exchange markets has tripled since 1986 to reach $900 bn per day. The yearly turnover of cross-border equity transactions correspond to 7% of world GDP. Market responses are both massive and immediate. The effects of changes in policy variables in one country will very quickly be transmitted to others.

The benefits for the world economy are substantial, but the globalisation of financial markets has sharply reduced the degree of macroeconomic interdependence.

Global financial markets exercise a very powerful discipline on national governments and limit the extent to which a government can pursue policies judged by the markets to be inappropriate.

Does this mean that national interests are at the mercy of speculators, of whatever origin ? No. It means rather that easy ways out of short-term national problems are revealed more rapidly than in the past to have immediate costs, particularly on currency markets, as well as the long term costs with which hasty reflation, in particular, has always been associated.

It is becoming increasingly obvious to policy makers that the reinforcement of economic interdependence brought about by these market developments calls for closer macroeconomic coordination. This is the most effective way of reducing global macroeconomic imbalances which hinder growth and encourage unwarranted speculation.

As I have argued in the past, when pleading the advantages of the ERM, the sovereignty that some governments saw outside the ERM is a fiction, given the influence of dominant currencies in the real world. The turbulence of this summer has major consequences for ERM coordination, but it remains the case that national macroeconomic sovereignty in Europe is a myth, as it is in much of the rest of the world. For Europe, monetary union remains the right objective, although the precise route towards it may not be the route we envisaged 3 months ago.

(iii) Consequences of Globalisation

In response to these changes, the nature of international economic cooperation is evolving in ways that we so far understand rather poorly.

The same technological revolution that has brought globalisation in the financial market is making it possible for manufacturing and service businesses to cooperate worldwide in ever more flexible ways. No longer is it necessary to launch a joint stock company or build a multinational.

On the contrary, the trend in company size is now towards the medium-sized or smaller enterprise. Smaller enterprises can work together more efficiently because the flow of information worldwide is more efficient. Joint ventures can concentrate on narrower market niches rather than a whole range of products. Producers and patent owners in Europe can select specialist partners for each product they wish to bring to markets. The market entry cost for overseas trade is dropping sharply, bringing the world market within reach of a wider range of small and medium-sized European companies.

If ways of doing business change so radically, the key factors shaping behaviour will be different. Already, import duties are less significant for exporters than are domestic regulations covering tax, safety or consumer protection. Already, there is less and less scope for a nation state or an economic community to improve life for its businessmen by acting alone. Nor, even internationally, can action be taken to increase world trade without looking at the implications for policy in the field of exchange rates, environment, national security, social welfare or human rights, most of which were hardly considered to be trade-related 10 years ago.

Recipes for success : 4 new Rules

If we are to make a success in this interdependent world, I believe we must work to 4 new rules :

- First, national economic interest must no longer be defined as limited to national boundaries or national companies.

- Second, we must be very wary of anyone who suggests that the solution to our European problems can be found solely within Europe. Europe is not isolated from the rest of the world and cannot pretend that it is.

- Then, we must recognise that in an interdependent world, it is more than ever vital to get our domestic policies right. Our international economic relations will flourish if we have got the right policies on investment, R & D, education, infrastructure and so on. We must also look at these policies in the countries of our partners since their apparently domestic policy decisions will also have an impact on us.

- Finally, in an interdependent world, the new European economic policy must be an open one. Not only an open trade regime, but also an open regime for foreign direct investment, for portfolio capital and for other forms of economic cooperation.

Let me add to these 4 rules, 3 flanking policies, without which they might not prove easy to sell :

- First, these rules should not produce a crude "laisser-faire" Competition rules, too, must be adapted so that they preclude a potentially pernicious effect of the new international networks. But where competition rules, properly defined and internationally coordinated, give a green light to particular activities, national policies must be constructed that welcome those activities and encourage Europeans to play their full part in them, not only here in Europe but worldwide.

- Second, we must maintain a European network of social support set at a level that we can sustain and pay for over the long term : that is the human face of our economy.

- Third, we need a more effective policy to integrate developing countries into the new world order. Their share of world trade and investment is slight and risks stagnating. This plight will worsen if we do not increase our efforts to ensure that the developing world is plugged into the new economic networks. Development policy will acquire a set of fresh objectives.

(iv) Coordinating Policies

If these are the rules for success, how can we make sure that we follow them ? Europe cannot align itself passively on trends set elsewhere. Our aim must be to shape future world trends, to develop with our partners the policies that suit all our economies.

How can we do this ? First, we must be first. We must develop in Europe the policies that matter, sell them to our partners and agree worldwide how best to put them into practice. The Single Market experience showed the way to do this : by grasping the nettle of regional integration, the Community had a head start on the rest of the world.

But good ideas need more than our own enthusiastic advocacy. Having initiated policy debate, sound and internationally recognized independent evaluation is essential. The analytical capabilities of international institutions must be kept in trim. The OECD Secretariat is a good example. Non-governmental contributions are also valuable, whether from single-issue expert groups, business, organized labour, academia or any combination.

Beyond such government activities, dialogue between economic players themselves is important. The annual meeting of industrialists and politicians at Davos is a very useful example. There are many similar institutions designed to foster relations between businessmen in two or more major economies. While informality favours the development of ideas, it does not always ensure that those ideas are delivered to decision-makers. But when industrialists find a way through to politicians and bureaucrats, the results can be impressive. In the Uruguay Round, there is certainly a higher degree of trade liberalisation in sectors where EC, US, Japanese and other industrialists took an active interest in the outcome of the process than elsewhere. Chemicals is just one example of this.

Once the need for a new international policy and the broad lines to follow begin to emerge, rule-making may (but will not always) be needed. Long-winded and bureaucratic though they may seem, multilateral institutions bringing together from 20 to 120 national governments are essential to creating world rules.

I have mentioned OECD already : its role, like its membership, must grow. Regional economic organisations must also help. But we need a single overarching organisation to ensure that regional initiatives remain consistent with open world trade.

The Multilateral Trade Organisation, successor to the GATT, will become the kingpin of trade policy worldwide. It will need continued support from the IMF and World Bank. The relationship between this Big Three needs to be closer.

What are all these relationships going to achieve ? What should be the objective ? Primarily, to pursue further the progressive reduction of obstacles to international economic relations, as has been the objective of Europe since the signing of the Treaty of Rome. The means to this end have changed somewhat. Tariff reductions are not enough. The essential now is to achieve agreement at international level on the proper shape and level of regulation in new areas. That is really required before Europe or other players start to legislate on their own. "Regulatory convergence" of this sort can avoid the creation of technical barriers to trade, and sometimes even produce better domestic policies than individual players would have produced on their own.

Without such convergence, national initiatives can be very damaging to European interests, as we have seen clearly on many occasions. In the aftermath of Chernobyl, for example, many of our trading partners imposed zero tolerance for background radiation in food products. The result was a series of import bans on products that were produced and sold in Europe and that were, in the judgment of competent scientists, perfectly safe. It took the EC many months to negotiate a way through these unreasonable obstacles to our exports. The result was lost sales, lost jobs in Europe, and all for no improvement in health protection in the other countries concerned.

Another example arises in the field of competition policy. Competition is traditionally seen as a prerogative of national policy. In an interdependent world, dangers to fair competition in national markets can result from activities initiated beyond national borders. In order to deal with this threat, those dealing with competition policy in the European Community and elsewhere have inevitably been led to assert jurisdiction over those acting in another country whose action has the effect of damaging competition within their own territory. There is bound to be a risk of serious conflict if both the country in which an action took place and that where it has its effect assert the right to deal with what has occurred, all the more so if they take a different view as to whether the conduct concerned was objectionable.

In order to deal with this problem, the first step is to seek agreement on a system of mutual consultation and co-operation with Competition authorities elsewhere, in order to forestall potential conflict. We have reached such an agreement with the United States and are in the advanced stages of negotiating such an agreement with Canada.

But cooperation and consultation cannot always resolve the problem. Even after mutual consultation there may remain a genuine difference of opinion as to who should be responsible for handling a problem and what the solution to it should be. We need a set of international rules for handling such competition cases, going beyond consultation and co-operation. Achieving effective rules of this kind will be difficult and time-consuming, but it is high time to begin the process.

The MTO should certainly include restrictive business practices and cartels on its immediate agenda. The aim should be to draw up common rules, lay down the principle that restrictive arrangements are not enforceable at law and that Governments are responsible internationally for the implementation of these rules and procedures. The right of recourse to GATT panels should be strengthened, as should the effectiveness of their adjudications. For mergers, common rules should also be established, as well as a common commitment to enforce them.

Other key issues for the new agenda will be trade links with the environment and a further deepening of international investment rules. It is an earnest of my faith both in the December deadline for dealing with the current GATT agenda and in the need for urgent action on all these issues thereafter that the Commission is already laying the groundwork for these negotiations with key trading partners and in OECD.

(v) Conclusion

To conclude. National economies are linked with one another by a wide range of transnational business activities. This means that there are many areas where their interests coincide. At the same time economic operators vie with each other for advantage in an increasingly global business arena, helped or hindered as the case may be by national governments.

In these circumstances economic nationalism is not an option. Cooperation in areas where common rules and policies are effective is perfectly compatible with national efforts to boost growth and flexibility at home. But since we all gain from a growing world economy, governments must act together to provide the competitive environment which promotes wealth creation. The bigger the cake, the more for everyone. At times of recession and of global political change, this message of trust and cooperation can sound naive. It is not. And in the global economy a contrary policy of unfair or beggar-my-neighbour policies would leave us all worse off. As one famous Anglo-Saxon freedom fighter argued, rallying his colleagues at a critical moment, if we do not hang together, we shall assuredly be hanged one by one. A grim message, but a useful remainder of what mutual dependence means.

Primary discussants:

1. ***Drs T.J. van HEESCH, Director of Philips International BV, Eindhoven (NL)***

Mr. Chairman, Sir Leon, Honourable Members of European Parliament, Ladies and Gentlemen,

Representing Philips Electronics, my first duty is to thank you for inviting us to participate in this Hearing and to present our views.

Philips, as you know, has been and still is very much involved in the Single Market concept and its implementation, for the simple reason that two-third of our business takes place in Europe, that about half of our factories are in Europe, and that the bulk of our Research and Development activities take place here.

At the same time, Philips is very much involved in global market developments: First of all because the remaining one-third of our business takes place outside the Community. Secondly because many of our subcontractors, our purchases and some of our technology comes from outside Europe. Global market developments have therefore an increasing impact on our European business. The subject of today is therefore close to our hearts.

We have read with interest your discussion paper and like to congratulate you on the quality of your analysis. We also agree largely with your conclusions at least on a conceptional level.

Sir Leon has, in his excellent speech, said that we in Europe must develop the policies that matter, sell them to our partners and agree worldwide how best to put them into practise. In very many ways the Community and the thinkings of Sir Leon is being presented as an example of more far reaching multilateral arrangements. There is a message here: The EC as an example for the rest of the world. It might therefore be useful today to elaborate on the actual implementation aspects of the Community's policy with regard to liberalisation. Liberalisation is rightly a key issue in the discussion paper, and we are very much supportive of this. However, as a private company we are confronted daily with implementation problems that go beyond our reach, requiring political actions by governments. In the rare cases that we succeeded in triggering such actions, the result is generally too little too late. What really matters, at the end of the day, therefore, is the effectiveness and the efficiency of Community actions in implementing Community policy without disputing its overall objectives. My remarks may sound rather critical but are meant to be constructive.

In creating the Single Market it was clear from the beginning that this market would be of interest and benefit not only for European companies. To defuse the threatening concept of the Fortress Europe, market access by non-European companies was based on the concept of reciprocity. This sounds good in theory but is very difficult to implement. Apart from technical problems like differences in market structure and regulatory environment, our main trading partners do not show a great enthousiasm for this concept. Their governments apparently do not see great advantages in opening up their markets as long as they see that non-European companies are quite welcome in the Community without their governments fulfilling this condition of reciprocity. In fact, the current atmosphere in the US is to become more discriminatory in applying "national treatment", as illustrated by the Manton amendment which would provide a restricted access to government-sponsored R&D programmes by non-American companies. I can assure you that we would be severely restricted by this amendment would it really come into force in the United States.

Consequently the "miracle" solutions offered by the European Commission to protect the interest of European companies turns out to be ineffective and powerless. For example, the Community has so far been unable to harmonise, streamline and speed up its decision-making procedures of commercial defence, despite the unrelenting pressure of the REX Committee.

I think business realises that this lack of power cannot be blamed on the European Commission as it relies on the Member States for clear and strong mandates in negotiations. What can be said is that the European Commission has overestimated the willingness of the Member States to delegate its trading powers to the Commission. In fact, the political reality of today is that the responsible Commissioners have to fight harder with the Member States than with their trading partners. And as this entire process is transparent they stand even to lose authority in subsequent negotiations. As a consequence, the Community cannot respond in any meaningful way to for instance unilateral sanctions by our main trading partners as shown in the recent steel-dumping case with the US. The recent monetary chaos, which by the way has caused us to write off in 1992 150 MECU of our bottom line, serves as another example, where economic interdependence has no meaningful translation into multilateral regulations and policy coordination.

European industry is thus very exposed to global competition. Moreover, European industry is vulnerable. To take advantage of the Single Market, it has to restructure its operations which, certainly in the case of the electronics industry, were initially national in scale and scope. Philips for instance had to go through a process of concentration of its manufacturing activities which implied the closure of about half of our factories in Europe and the scaling-up and modernisation of the remaining sites. The costs of such restructuring in Europe are - for obvious reasons - enormous and have weakened many European companies financially. Philips alone has spent some 4 billion ECU on restructuring activities in the period 1980-1990. If only we could have added this enormous expenditure to our bottom-line! At the same time, non-European companies are penetrating the open Single Market without the burden of such restructuring. They are sometimes even subsidised with Community money if they set up factories in certain less-developed regions. It could well be argued that the Community's policy of a level playing field as a condition for fair competition should take account of such disparity in starting conditions.

Finally, Community policy has developed into a set of "vertical policies", addressing various aspects of society. Everybody will agree that these policies have interlinkages. In fact, it is more and more recognised, that a "policy for industry" (to avoid the expression of "industrial policy") should embrace a whole series of policies like for instance environment, social, competition and trade policy. Probably because of the "vertical" structure of the Community institutions, the Commission has not yet succeeded in presenting a comprehensive and balanced policy and in providing industry in Europe with the kind of predictable conditions that bring about economic growth and employment. Admittedly "verticalisation" is a problem at the national scale as well, as it is - for that matter - for large, diversified companies. That however is poor justification and should certainly not be seen as an example to follow. Economic interdependence is a very complex and many-facetted area that needs to be approached in a comprehensive way. If the Community wants to serve as an example for more far-reaching multilateral arrangements and policy coordination, there is still a lot to do. In fact we do worry: we are discussing multilateral arrangements, yet national interests seem to be on the winning hand.

I thank you for the opportunity to express our concerns about the current developments within the Community and between the Community and the rest of the world. Our view is of course biased as it is an industrial and not a political view. If we were critical of certain aspects of policy by the Community institutions or by other multilateral institutions, it is because we would like to see a Community as well as other multilateral organisations that can act with authority, sacrificing its internal disputes to overriding common objectives and being strong and respected parties on a global level. The coming months will show whether this is a dream or reality. The Community in that respect should get its act together. We have no time to lose. If we do not, economic interdependence - as far as Europe is concerned - will become economic dependence.

2. *K. CHIBA, Counsellor of Mitsui & Co. Ltd., Tokyo (Japan), Ex-Ambassador of Japan to the United Kingdom*

I am very happy that I have been invited on behalf of my country to take part in this intellectual exercise. After all, this sort of exercise is very necessary for the world to see what it is like and what should be done. The necessary stimulation and provocation has been amply provided by Prof. DORNBUSCH's paper. I think there are many points which I would like to talk about but I shall - since I am one of the principal discussants in the afternoon - leave it to the afternoon, maybe in the absence of the Professor. I hope he will forgive me in that case.

I would like to say that there are certainly some problems caused by Japan. I can say this because I am not an ambassador any more, only a former ambassador. I will first admit that our rice policy is not to my liking. In fact I am a consumer in Japan and I also belonged to the foreign service which was trying very hard to do something about it. So having given you my personal sympathies I would agree to a certain extent with Prof. DORNBUSCH's arguments. But as concerns the analysis which he presents about the closed nature of the Japanese market it seems that the light concentrated on it is a bit too blinding, and makes one not quite sure what is really wrong with us. In fact, his analysis is a bit strange for one of an oriental heritage but also educated in the West (Mr DE CLERCQ knows very well as we were together as students in America, alas 40 years ago). Anyway, the logic seems to be, I am afraid to say, not impeccable, especially when the nature of Japanese 'protectionism' or the closed nature of our market seems to be very abstract. In a sense that it is like an onion, you peel it and you find only a void at the centre, maybe it is a very pungent void but it is not logical. We have, as I said earlier, many problems but so has everyone else, we have our special interests and so have other countries, so have the EC. Rather than point out Japan as some sort of Pariah which does not fit into the world, I think the better approach would be to try to analyse it a bit more rigorously and try to find out what is causing this great surplus of the Japanes foreign account. What is going to be, for instance, the effects of the very drastic appreciation of the Yen which, unfortunately, in the paper seems to be considered as a little blip, of course I must say, the Professor does not use those terms, but I think that is what he implies. It is having a very drastic effect on us and if he had looked at the Japanese trade figures, not in Dollars but in Yen, you can see that the surpluses are going down at a very quick rate. The Yen is not an international currency but nevertheless when it comes to Japanese companies who operate in the real economic world it is a cause for great alarm and restructuring is now actually starting. Maybe you have heard that even the so-called sacro-sanct lifetime employment (I suspect this is an invention by Western Journalists) is at stake.

In conclusion, I would like to emphasise that, first of all, we are not different from you, with similar problems, which sometimes get out of hand. Basically we have weak sectors in our economy which are protected, we have weak producers who have to be provided with a safety net and this is not uniquely Japanese. Europeans and Americans will recognise their own visage in the mirror held up in this manner. Secondly, though I can understand the exasperation of the Americans, especially in Congress, which Prof. DORNBUSCH very faithfully reproduces, I am alarmed when he says that the EC and the United States should join in - he does not use the word "force", but I think he implies, forcing Japan to open up. This, of course, is a rather dangerous course even if it were argued very impeccably - which it is not, unfortunately. So if you give some sort of sweeping prior statement like this, one is reminded, unhappily, of the late nineteenth century when the Europeans and alas, even the Americans engaged in so-called gunboat-diplomacy. This argument will not touch Japan alone, but also the rest of Asia, as I think Mr CHO mentioned China and America as possible candidates for trade friction earlier. As China is bigger than Japan, this sort of argument will not just stop with Japan.

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I want to thank you again for allowing me to let off some steam this morning. I said at that time that I will try to give a more detailled critisism of the DORNBUSCH paper. In the afternoon I will not do so, both in the interest of time and also that the heat of the battle has gone out of me with the steam. I think we all realise that interdependence is now something which is very real, almost tangible. We see it every day, especially in the private sector, when even the most obscure company in Japan does have business dealings with Korean companies or Thai companies, for example, Sir Leon has just pointed out the enhanced role of medium and small enterprises in the international field. I think this is happening all over the world.

The paper which has been presented by the - should I say the Commission? - I am quite a newcomer to the thicket of European bureaucracy, so I hope you forgive me if I make any mistakes. This paper when shown to my friends in Japan - both in the private and the public sectors - the unanimous Japanese reaction was: "This is too good to be true!". And people wanted to know: Was this a Commission paper or was this commissioned by the Parliament, or was it some private person who had written such a marvellously good paper! People took this as a snapshot of the Europeans without horns on their heads anymore.

The speech by Sir Leon combined with this paper is, I think, a very good example of the high level of the European intellectual application to the problems of the world today. I think we in Japan have to learn a lot from the Europeans; notice that I am not talking about the Americans, because that is not in my brief. But the Americans, of course, are a very important entity in the world. I would like to think of three pillars, the Americans, the Europeans and the East Asians (not just the Japanese), holding up the world economy as we go into the twenty-first century. Eventually new players will emerge, we already have talked about the Chinese, the Indians and perhaps the Russians as well today, but we the three pillars do have the responsibility. The three pillars are very different from each other and they do have lots of quarrels with each other, certainly. But I do think that it is almost an established fact that nobody else would be capable of holding up the world. I believe that this paper which you have produced and Sir Leon's talk is very much in the right direction, pointing towards the twenty-first century.

I would like to add that from the Japanese point of view, maybe you find this hard to believe, but there is a strong feeling amongst those who count in Japan, that our collaboration or cooperation with Europe is a matter of our own interest. It is not just a matter of convenience, it is indeed a vital interest for Japan that we have a good working relationship with Europe. Otherwise the three pillars will not be able to function. The times which we are now facing together are very difficult times. Some countries have gone into recession earlier and, therefore, coming out a bit earlier. But Japan is right now in the middle of it and in unprecedented type of economic downturn. This is very different from the challenges we have had in the past. I will not go into details but more than anything else, more than any Japan bashing or more than any pressure put by eminent statement the world over, this economic downturn is changing our economy. It has indeed changed our politics, although it is not yet so noticed. May I just give you a very brief description of the HOSOKAWA Cabinet, which is a very different animal from the previous Democratic Party government. It is, however, basically a conservative but a moderate regime even if it does include the Socialists and some, if I may say so, die-hard lefties. The latter are there because - and I hope you will not accuse me of being cynical - power is sweet. The people still yet in the first months now of their new coalition are holding on to power and holding down various diverging opinions. I don't know how long this will last, but it still and I therefore characterise the HOSOKAWA Cabinet as a kind of national unity government, which may or may not be going to last a very long time. They are capable however at this moment of initiating changes; whether they will carry it through, both in the political or economic domains, I don't know, but they are at least confronted with 'a window of opportunity'.

One more thing is we are now having a generational change in the Japanese political world. This again is reflected although not intentionally or even knowingly in the economic world. The structures of the companies are changing very rapidly under the surface. The so-called 'life-time employment system' is being very swiftly eroded behind the scenes by the appreciation of the yen. Another aspect is that companies in Japan are ditching their old 'Keiretsu' suppliers. This setup, according to the Western picture of 'Japan Inc.', is as right as a Macedonian phalanx, is now very quickly disintegrating, like the phalanxes disintegrated before the Roman legions. People are now buying from foreign companies if the price is right and the quality is not too bad. Of course there is the question of 'after care' and that sort of thing, but the change is happening very quickly now. Although many people do not realise it, even in Japan.

We who are now engaged in such change have no choice but to go whole hog. I mentioned rice is our politics this morning. I am sure the system will have to change before long. In fact with the very bad weather this year, we anticipate a great shortage of rice, and therefore our Ministry of Agriculture is quietly starting talks with the American Department of Agriculture and other authorities on the problem. A tremendous amount of change is going on; since these changes are shared by everybody in the world, we should be better off hanging together than hanging separately. The first order of business, as Sir Leon has correctly pointed out, is to make the Uruguay Round a reality. This of course is easier said than done. But unless we can do that all this talk of the three pillars collaboration and cooperation will just go up in smoke. We believe that the three pillars should not quarrel with each other but compete with each other. They should not try to impose their views on the developing world but should be cooperative in a far-sighted way, and this I hope is coming to pass.

I will finish by giving you some private thoughts. The Asian region is still buoyant and I think in the European region you have the Eastern European countries with their great unsatisfied demand, but they do not have the pump priming necessary for this demand to manifest itself. In the long run perhaps the European Community and Japan and of course the Americans can co-operate in aiding the Eastern Europeans in a judicious way not just throwing money into a black hole, in order that demand to become a reality and therefore the Europeans, the Americans, the Japanese and the other Asians can export to - and import from - the Eastern European countries. This is a long term proposition but it is one possibility. I have privately talked to the Japanese government people in charge concerning the above-mentioned aid, who said under our laws and regulations no such provision exists. You can see that to solve the problem we will have to change things in Japan itself. But please be reassured that in Japan we do not regard the European Community, or the enlarged Europe, with dread anymore or with enmity at all. We still think even though we are bashed once in a while, even though the Americans do bash us, after all our best friends are the Europeans and the Americans, and I am not joking - I am told -, we Japanese are not supposed to have a sense of humour. Anyway my message is that we shall read your paper again, we shall reread Sir Leon's talk and try to come out with a wiser way of doing things together with you. Thank you.

3. *D. MacSHANE, Secretary of the International Metal Workers Federation*[1], *Geneva*

The tidal wave of papers, books, and conferences on the globalization of the economy, on international economic interdependence, and on the helplessness of governments is washing over us.

The three "C's" of Capital, Companies, and Commodities are to be freed from any social accountability or control in the name of economic progress. A token nod is made in the direction of the environment but accelerated economic growth and trade are to come about by lifting barriers or regulations governing the three "C's".

The way forward is to de-regulate, privatize, surrender national controls over economic matters, and specifically in the case of Europe, cut wages, welfare, and worker protection.

The Financial Times informs us that EC Commissioners have seen the future and it is more work for less pay. At a private conclave early in September 1993, "Mr Bangemann (Industry) urged more short-term employment contracts ... Mr Schmidhuber (Budget) and Mr Matututes (Energy and Transport) said Europe's welfare system discouraged people for working, while Sir Leon Brittan (Trade) said there was nothing wrong with lower wages."[2]

At least these gentlemen are honest. This is the first time in 20th century, possibly world, history when political leaders offer the prospect of a worsening of life to their subjects, not as a result of war or geo-political revolution but as a conscious act of policy.

It is little wonder that faced with this kind of language the citizens of Europe become deeply unhappy about the European project and vote against men and ideas that offer a worse not better life, and a reduction not a strengthening of the thin and ungenerous social system currently in place.

For while the three "C's" of Capital, Companies and Commodities are given greater rights, freedoms and power to move and act as they wish, it is often forgotten that a fourth "C" exists - that of the Citizen who casts a vote and thereby also has a voice.

And unless the new world order of economic integration and interdependence brings with it an institutional network that connects to the citizens of Europe (or in the United States vis-à-vis NAFTA) in a positive sum way the chances are that a retreat back to the nation or indeed the tribe will accelerate. This movement hacia a dentro or turn to Heimat is accelerating in proportion to the

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1 This position paper was prepared for submission to the European Parliament hearing on the subject of "Economic Interdependence - New Policy Changes" held in Brussels, 28 September 1993. It should be read in conjunction with the Action Programme 1993-1997 of the International Metalworkers Federation adopted at the IMF Congress, Zurich, June 1993

2 FT 3 September 1993. The confusion of debate on this issue is summed by an FT report a week later which began "European industry needs urgently to change its costs structure to compete internationally and preserve jobs, even though many thousands of jobs will go as a result of such a reappraisal." (10 Sept 1993) We had to destroy jobs to save them, as the US general in Vietnam might have said!

de-politicisation of economic relations embodied by the new world international economic order.

The European Social Charter is a modest attempt to involve the citizen-employee in the post-nation economic project but is itself the result of lowest common denominator negotiation and scorned by Europe's most powerful global trading (not the same as producing) economy, the UK, as well as by all US and Japanese, as well as many European companies.

These points are well made in the discussion paper "International Economic Interdependence"[1] which is the spur to current discussion. Four disturbing conclusions emerge from this tightly argued and highly realistic document

(1) "The institutional means for managing international economic activity, for addressing its social, environmental and other consequences and for assuring the international cooperation, public and private, necessary to make the most of the new possibilites offered by scientific and technological progress, are not in general adequate to the task."

(2) "The present unequal distribution of the world's wealth - 80 % of it is concentrated in the hand of the industrialized countries, which together account for only 20 % of the global population - represents an enormous potential danger for all ... At the international level, a more intensive concerted effort is called for to address the imbalance in the global distribution of wealth. At the domestic level, this action involves such measures as education and retraining, creation of alternative employment opportunities, social welfare provisons etc."

(3) "Deregulation at the national level, which lies at the heart of an economy open to international trade, investment and other forms of transnational interchange has to be accompanied by multilaterally agreed minimum rules and practices, i.e. by international regulation."

(4) "A new, less adversarial approach to global questions, based on the recognition of interdependence, should therefore be fostered in all countries. This implies launching a systematic long term dialogue with the US, Japan and other industrialized and developing countires, both bilaterally and in multilateral forums."

Each of these points needs to be addressed not separately but together at all levels of economic, social and political activity. Thus wealth distribution between North and South is also a question of wealth distribution within individual societies. The term de-regulation at national level is often a misnomer. What has happened are not fewer rules but different rules. British trade unions for example have "enjoyed" no fewer than seven new laws since 1980 which have re-regulated their scope of action in favour of capital and employers.

It is little use calling for "a new, less adversarial approach to global questions" when the consensus and compromise that has governed relations domestically is being torn up in favour of the hammer blows of government or employer change being imposed unilaterally on workers or poor people. The German economic minister Rexrodt proposes to tear up the carefully constructed social market state developed over 40 years of conflict and compromise. How in this

[1] DG for External Economic Relations, 17 May 1993

hightened atmosphere of adversarial politics can appeals to global compromise and dialogue be heard?

Internationalism, like charity, begins at home. In the specific home of the EC, the need for enhanced dialogue and policies that reflect domestically what is sought internationally are necessary. The politics of "Do as I say, not as I do" are counter-productive when appeals to international co-operation and agreement are contrasted with the me-first and winner-takes-all style of much domestic political economy.

What then are the ways out of the present impasse?

Three suggest themselves.

Firstly, to learn from history and current experience. Thus, we may examine periods of world growth in GDP and trade in the 20th century and ask what conditions existed in period of high growth in GDP and trade.
in tabular form it may be presented thus:

Year	**% Growth in World GDP**	**%Growth in World Trade**	**Prevailing Political Economic Policy**
1961-70	5.3	7.7	Currency control/stability. Expanding social welfare. Full employment as policy goal. Open immigration. Unionized collective bargaining. Civil society in economic sphere develops. Social ownership.
1971-80	3.9	5.3	Dollar floats. MNCs develop off-shore production. LDCs given massive loans. Immigration stops. State pay policies. Confrontationary human resource management.
1981-1992	2.6	4	Free movement of capital. Privatization transfers power to capital. Unions attacked in UK, USA, and Poland. Marked wealth transfer to rich. Loan repayment crisis. Employment sacrificed as policy goal.

Source (for stats) Eurostat, GATT

It appears therefore both world GDP and trade increase most when the most socially responsible and ownership-diversed economic policies obtain. This, to any policy-maker, should provide clues as to what needs to be argued for in the new global economic paradigm.

Serious analytical research needs to be undertaken to ask whether the welfare state is the result of economic growth or the cause of economic growth. Europe after 1945 developed its political economy on the premise that certain social rights would be incorporated. The fears of unemployment, homelessness, and ill-health that disfigured Europe in the first half of the 20th century were not to be repeated.

The production of welfare guaranteed the welfare of production. Relations of commerce would replace relations of power. This was the new synergy between social and economic Europe that lay at the heart of European success, not just of EC member states but of all democratic Europe. Now instead of being partner there is an attempt to divorce society from the economy and to sacrifice social relations to the profit of economic ones.

The second line to follow would be to examine which economies in recent years have met the target of growth, full employment and no decrease in living standards. If the single target of job creation is taken then the US comes out on top. But when we look a little deeper and ask two further questions - what kind of jobs and what kind of society has emerged comcomitant with this employment creation - then the automatic reference to the US example becomes less clear.

In terms of what kind of jobs, the economic life of the US citizen has become more brutish, more nasty, and in terms of working hours not any shorter. While real GDP in the US has grown by 56 per cent over the last 20 years there has been a 16 per cent decline in real hourly wages.

Since 1973, the time necessary for an American worker paid the average hourly wage to earn the average household's yearly expenses has grown 43 per cent; to buy the average new house 45 per cent; and to pay for a year at the University of California by 75 per cent. [1] The World Bank noted earlier this year that if the black population of America was treated as a nation in terms of economic wealth and living standards, it would be placed in the upper half of third world countries. The US model creates more jobs than in the southern EC states but at the price of social dislocations (37 million without health insurance, growing crime, poverty and drugs, city centres that no-one dares walk in) which would be difficult to impose on Europe.

Instead, Europeans might look at successful European economies such as Austria or Norway or Sweden (before the recent neo-liberal government decided that the way forward for Sweden was to increase unemployment and resultant transfer payments).

Thirdly, if we look at the dynamic Asian economies what features do we see. Firstly, narrow wage differentials. Secondly, massive investment in education (Singapore). Thirdly, public ownership of land (Hong Kong). And at the same time, a big explosion in pay (up 250 per cent in five years in South Korea) if democracy is permitted.

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[1] FT 3 September 1993

Of course, some dynamic Asian economies can deny civic rights to employees (e.g. the total ban on union membership for all 130,000 electronics workers in Malaysia) or keep 10 million in forced labour camps pour decourager les autres (as in China) but if that is the desired means to the end of economic competitiveness of those who wish to dismantle EC wage, welfare and union levels then it would be more honest if they were to say so.

Instead, Europe might consider taking a world lead in arguing for a new social-economic model that would take into account the following:

- technology has outstripped the need for labour
- caring should not be reduced to domestic service
- human-centred economics delivers better than money-centred
- monopoly systems of ownership need to be pluralized
- international economic activity should be the servant not the master of international civil society

There are examples from each EC member state that can provide clues as to ways forward.

- Britain, for example, shows the possibility of lifting health-care costs from the backs of employers through its centrally-funded National Health Service. British representatives should be encouraged to promote the virtues of their NHS in terms of its contribution to economic efficiency.
- The training of workers in the Netherlands and Germany is a model for improving the supply side of the labour market.
- The current discussion between governments in France and Spain and their trade unions about new social-employment plans shows how the workplace civil society incorporated in unions can play a positive role.
- Worker and union representatives will sit on the supervisory board of the recently merged Renault-Volvo auto company - another pointer to a European solution to current dichotomies between economy and society.

In summary form, the increasing global and regional economic interdependence requires the following reaction from policy-makers. They should seek to:

(1) Re-insert full employment as policy goal;

(2) Link social issues to economic growth via social clause in GATT. The call for a "World Social Charter" by the UK Employment Minister, David Hunt, is interesting in this regard. A 10-point World Social Charter may be found the International Metalworkers Federation Action Programme 1993-1997;

(3) Strenghten economic citizenship transnationally, notably through European Works Councils;

(4) Research new products and processes harnessing knowledge adn skills of production and service workers;

(5) Enhance European democratic institutions, notably European Parliament and other institutions of European civil society such as ETUC;

(6) Seek to strengthen unions as essential pillars of international civil society based on contribution that unions have made in Poland, South Africa, South Korea;

(7) Define negative and positive freedoms in economic sphere;

(8) Move from passive to active society policies in line with speech made by EC Commissioner, Padraig Flynn, to TUC Congress, UK, 6th September 1993;

(9) Open borders and institutions to East Europeans;

(10) Put civil society, social movement protection into all EC trade agreements;

(11) Take advantage of window of opportunity for social issues (Clinton Jobs summit, ILO 75th anniversary, OECD employment studies, UN Social Summit) to argue for European model;

(12) Proclaim European diversity in unity and have political faith in the European project instead of endlessly seeking to impose American or Asian economic-social relations on Europe. Draw instead from the positive aspect of the US and Asia, instead of a wholesale transfer of US/Asian model.

IV. SUBMISSIONS

1. TRADE AND THE THIRD WORLD - PRIORITIES FOR THE EUROPEAN COMMUNITY

C. Aid, Oxfam, the Catholic Institute for International Relations World Development Movement

(i) Introduction

Trade is vastly more important to developing countries than aid. Aid accounts for only five per cent of the income of the Third World; trade represents more than 80 per cent. For many Least Developed Countries, the EC market accounts for fifty percent or more of total exports.

Yet the present structure of EC trade with the Third World prevents them developing their export potential. According to UNCTAD, 83% of manufactured exports from the Third World to the EC encounter trade barriers. Such restrictions are estimated by the World Bank to reduce poor countries' earnings by 3% a year.

The 1992 World Bank report "Global Economic Prospects and Developing Countries", estimated that a 50 per cent reduction in the trade barriers of Europe, Japan and the US would increase developing countries' exports by $50 billion per year - just less than the annual $57 billion aid they receive.

Recession and unemployment within the EC are creating serious pressures on member countries to adopt protectionist measures. Such measures not only harm poor people in poor countries - they also serve to prolong the worldwide recession. Only if poor countries can sell their goods to the EC, will they be able to afford to buy the EC's goods and services.

Through their work with partner organisations in the Third World, development NGOs throughout the EC have become increasingly concerned that all too often the EC's trade policies directly and indirectly harm the struggling economies of poor countries.

With the GATT negotiations coming to a crucial point, the future of the Multi-Fibre Arrangement still unresolved, and the EC looking at the implementation of the second phase of Lome IV, the EC must take this opportunity to improve its trading relations with the Third World.

(ii) The Third World and Maastricht

The Maastricht Treaty strikes an encouraging note. It writes overseas development into the European Treaty for the first time. In Article 130u it commits Europe to a development policy that will foster:

- the sustainable economic and social development of the developing countries, and more particularly the most disadvantaged among them;

- the smooth and gradual integration of the developing countries into the world economy;

- the campaign against poverty in the developing countries.

The EC's trade policy is not consistent with these objectives of development policy set out in the Maastricht Treaty.

Article 130v of the Treaty is therefore of the utmost significance. It commits the Community to take account of the specified objectives for development policy 'in the policies that it implements which are likely to affect developing countries'.

This commitment was underlined last December in a declaration by the EC Ministers of Development Cooperation: the EC "recognises the linkages between development cooperation policy and other Community policies. It also recognises the need to take account of their impact on developing countries, which can be significant."[1]

Now that the Community recognises the linkage between its development cooperation policy and other policies, it should take action.

This submission examines the impact on developing countries of the following EC policies:

(a) The common tariff policy;
(b) Textiles and clothing policy: the Multi-fibre Arrangement.
(c) The Common Agricultural Policy.

This submission:

- assesses the impact of these policies as they currently operate;

- outlines why recent and anticipated reforms are inadequate to achieve coherence with the stated objectives of EC development policy;

- makes recommendations for policy reform.

(iii) Summary of recommendations

1. Overall trade policy

The EC should review its trade policies to ensure that they are consistent with the development policy objectives set out in the Maastricht Treaty.

2. Tariffs

The EC should remove tariffs that rise according to the level of processing.

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1 Declaration of the Council and of Representatives of Governments of member states meeting in the Council on aspects of development co-operation policy in the run-up to 2000.

3. Clothing and Textiles

The EC should:

i. Start phasing out the MFA immediately, lifting first and fastest quotas on the poorest countries, with all barriers removed by the year 2003 by the latest.

ii. Take Bangladesh, as the only Least Developed Country within the MFA, off the EC's list of MFA exporters immediately.

iii. Promote basic worker rights in the countries with which it trades, particularly the rights to organise and to free collective bargaining.

4. Common Agricultural Policy

The EC should establish a unit in the DGVI to monitor the impact of the CAP and changes to it for Third World countries.

- Beef Sector

The EC should:

i. Abolish subsidies on beef exported to west Africa.

ii. Investigate the impact of subsidised exports to other developing nations.

iii. Increase aid to the livestock sector in west Africa.

- Sugar Sector

The EC should reduce sharply domestic production while protecting the interests of the ACP states signatory to the Sugar Protocol. The main report contains detailed recommendations covering Subsidised Exports; Financial Aid for Diversification Trade Restrictions; Freight Costs; the Portuguese Market.

- Cereals Sector

The EC should:

i. The withdrawal the price support and other payments linked to levels of production in excess of Community demand.

ii. A commitment to phase out, over a five-year period, all direct and indirect export subsidies.

iii. Support less intensive, more sustainable forms of agricultural production in the EC, based on lower levels of output.

(iv) Trade and the Third World: Priorities for the EC

(a) Common tariff policy

The world's poorest countries rely heavily on a small number of primary commodities, the price for which has been plummeting. The World Bank commodity index fell 30 per cent in the 1980s (ie purchasing power was cut by a third). For sub-Saharan Africa the fall was 50 per cent.

Throughout the 1980s the economic adjustment programmes prescribed by the International Monetary Fund and the World Bank, and adopted by many Third World countries, encouraged the increased production of traditional primary product exports. These programmes are based on the idea of 'comparative advantage' - developing countries should grow tropical products, and use the foreign exchange earned to import cheap food produced by subsidised farming in the North.

Producing more of the same is no solution to these countries' crises. For 60% of Sub-Saharan Africa's exports demand elasticities are so low that an increase in the volume of exports actually leads to a fall in earnings. In Ghana, for example, a 50 per cent increase in production of cocoa between 1983 and 1989 was accompanied by a fall in foreign exchange receipts.[1]

A way out of the commodity trap is to tap the greater profits to be made from processing, packaging and marketing. However, the EC's tariff structure works to stop Third World countries developing processing industries, and to maintain their dependence on primary commodity exports.

While raw materials may be allowed in duty free to the EC market, processed products face significantly higher barriers. The greater the degree of processing the high the tariff. For example, the EC duty on cocoa beans, is three per cent, on cocoa butter 12 per cent and on chocolate 16 per cent.

Prospective Reforms

The GATT Uruguay Round negotiations have not yet focused on this area. The danger is that it will be left until very late and tied up too quickly after the log-jam between the superpowers have been cleared. One of the results of the last GATT negotiations, the Tokyo Round, was, for many tropical products, an increase in tariff escalation.

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1 Frances STEWART: Are Adjustment Policies in Africa Consistent with Long-run Development Needs?, *Development Policy Review*, Vol. 9, 1992.

Recommendations

- **The removal of tariffs that rise according to the level of processing.**

(b) Textiles policy: the Multi-Fibre Arrangement[1]

Textiles and clothing exports are of central importance to many Third World countries. They account for over a quarter of the Third World's manufactured exports, compared to less than 5 per cent for rich countries. These exports have provided a first step towards industrial diversification and away from dependence on commodities.

The Multi-Fibre Arrangement (MFA) governs the bulk of textiles and clothing trade between rich and poor countries. It consists of a series of country-to-country limits on the annual shipments of clothing and textiles from the Third World in each of a wide range of categories.

The MFA is a complete 'derogation' from GATT rules, being based on bilateral trade arrangements, using quotas, and allowing rich countries to directly discriminate against poor countries' exports while leaving rich countries' untouched.

The MFA was introduced as a 'temporary' measure allowing industries in rich countries to adjust to textile and clothing imports from poorer producers. However, the real threats to textiles and clothing employment in the EC are from new technology and imports from other rich countries. For example, over 80 per cent of textile imports to Britain come from other rich countries.

Since its birth in 1974 the MFA has been renegotiated three times until the present MFA IV, which has been twice extended. Each renegotiation has seen the list of restrictions get longer and more complex. It represents a serious barrier to poor countries attempting to use trade in clothes and textiles to build up their economies and overcome poverty. Barriers to clothing and textiles cost the Third World an estimated £35 billion every year in lost trade -nearly as much as all Western aid.

Prospective Reforms

MFA IV was scheduled to finish at the end of 1992, just as the Single European Market came into place and a new GATT agreement was expected to begin. However, the EC missed this opportunity to start phasing out the MFA, opting instead to 'roll-over' the present MFA quotas until a Uruguay Round agreement is reached. This is highly unsatisfactory.

Technically the EC could start phasing out the MFA without a GATT agreement in place. Indeed, despite the absence of a conclusion to the Uruguay Round, the EC has already started a five year phase-out of all quota restrictions on Poland, Hungary and the Czech and Slovak Republics, with similar agreements coming into force next year with Romania and Bulgaria. The continuing delays to a GATT agreement should not be used as an excuse to prolong the life of the MFA. Instead the EC should follow the example of Japan, Switzerland and

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1 The information contained in this section is taken from: *Towards a fair trade in clothing and textiles: The Multi-fibre Arrangement, Europe and the Third World*, Submission to the EC by NGOs from Europe and Bangladesh, 1993, and *Threadbare*, by Ben JACKSON, World Development Movement, 1992.

more recently Sweden, countries which, although in the MFA, do not apply textile and clothing quotas.

The draft textile accord in the Uruguay Round Dunkel Text is "end-loaded", proposing a very slow phase-out so that most quota restrictions need not be lifted until the end of ten years. This delays yet again moves towards fairer trade for poor countries. Nor is it in the best interests of EC producers for whom a steady, gradual increase in competition would be less disruptive that a sudden exposure to greater competition at the end of ten years.

Recommendations

- **The EC should start phasing out the MFA immediately, lifting first and fastest quotas on the poorest countries, with all barriers removed by the year 2003 by the latest.**

- **Bangladesh, as the only Least Developed Country within the MFA, should be taken off the EC's list of MFA exporters immediately.**

- **The EC should promote basic worker rights in the countries with which it trades, particularly the rights to organise and to free collective bargaining.**

(c) Common Agricultural Policy

Guaranteed intervention prices allied to import controls have greatly increased European self-sufficiency in agriculture, so that substantial export surpluses have emerged in most sectors. Surpluses are transmitted on to world markets, normally with the help of substantial export subsidies.

These subsidised exports deprive developing countries of foreign exchange by reducing their market shares and depressing world prices. They also undermine Third World food systems by flooding local food markets with heavily subsidised EC surpluses. This depresses prices, reduces the household incomes of staple food producers and discourages investment in agriculture.

Although the EC has agreed a major package of CAP reforms covering cereals, beef and butter, there is no guarantee that reforms will be in the interest of the Third World On the contrary, desire to minimise change in the current balance of benefit for the EC interest groups affected by the CAP means that, if European policy makers are forced to take difficult decisions, there will be a tendency for the burden of adjustment to be transferred whenever possible on to Third World countries, because they cannot retaliate effectively.

There is currently no coordination of policy between the Directorate General for Agriculture in the European Commission (DGVI) and that for Development (DGVIII). We recommend:

- **the establishment of a unit in the DGVI to monitor the impact of the CAP and changes to it for Third World countries.**

The remainder of this section examines the trade and food security effects of the CAP on developing countries in three sectors of special interest to them: beef, sugar, cereals:

1. Beef Sector[1]

Problems for the Third World

Over the last ten years, the EC has greatly increased its beef production, generating enormous surpluses. Because of the high costs of storage, surpluses are sold outside the Community with the help of large subsidies. The EC has now become the world's largest exporter of beef, taking over a quarter of the global market. The Middle East, eastern Europe and Africa are the main destinations for this subsidised beef. The export of these surpluses can have a profound impact on local economies and agriculture.

Undermining EC Aid Policy

In the dry-lands on the southern fringes of the Sahara desert, fragile soils and uncertain rainfall mean that people cannot rely on cropping. Instead, millions of people in Mali, Niger and Burkina Faso rely on extensive livestock production to provide for their economic needs. Traditionally they sold their animals to the wealthier coastal countries like Cote d'Ivoire, Ghana, Togo and Benin.

However, since the mid 1980s large quantities of heavily subsidised European beef have been arriving in the region. This EC beef (subsidised to the tune of two ECU per kilo) is up to two-thirds cheaper than locally-produced beef, and thus destroys the market for African farmers. Since 1984, the EC has spent more than 400 million ECU in export subsidies to dispose of beef in west Africa.

This EC beef dumping not only undermines the efforts of millions in the region to survive, it also undermines the aid policies of the EC and its member states, which spend considerable sums on livestock support and other aid to west Africa. Practically all west African countries have received support, ranging from refrigerated abattoirs in Quagadougou and Bamako and improvement of cattle breeds in Mali, Gambia and Senegal, to fattening units and disease control in Cote d'Ivoire and Ghana.

The amounts of beef involved are large for west Africa. But they are a tiny portion - less than a half of one percent - of total EC production. The trade could be stopped with little or no impact on EC farmers, with big savings for EC budgets, and with enormous benefits for the people of the Sahel.

Recent and prospective reforms

It is unlikely that the current CAP reform will do much to bring beef surpluses down. While the May 1992 reform package attempts to reduce beef production, pigs and poultry may get cheaper, thereby reducing beef consumption in Europe and actually increasing exports. Meat and livestock Commission figures suggest that there will be a surplus of 960,000 tonnes for storage or export in 1993, even if Europeans eat more meat. [2]

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1 Petter MADDEN: Information given here is taken from Brussels Beef Carve-up: EC beef dumping in West Africa, *Viewpoint, a Christian Aid Policy Unit publication*, April 1993.

2 Martin PALMER: The Outlook for Meat and Livestock, Martin PALMER, Meat and Livestock Commission, *Agra Europe* 1993.

A GATT agreement based on the draft US-EC farm deal, the Blair House accords, would have a more significant impact on beef exports. The agreement implies a reduction in the volume of subsidised EC beef exports of 21 per cent and a reduction in the budgetary outlay for export subsides.

However, even with that reduction the EC still estimates that there will be 800,000 tonnes of beef a year available in the short term and 300,000 to 400,000 additional tonnes available by the end of the century.

If the current level of exports to west Africa went down by 21 per cent, some 40,000 tonnes of beef would still be dumped there in 1999. Moreover, in the short term pressure to get rid of existing stocks will be very high, which could mean an increase in the amount of beef sold in west Africa.

Recommendations

- **Abolish subsidies on beef exported to west Africa.**
- **Investigate the impact of subsidised exports to other developing nations.**
- **Intensify aid to the livestock sector in west Africa.**

2. Sugar Sector[1]

Problems for the Third World

The EC's share of world sugar exports rose from less than 9 per cent in the 1960s to more than 20 per cent in the 1980s, making the EC the world's largest exporter in 1982. In making this transition, the EC contributed to the collapse of the International Sugar Agreement in the early 1980s, which in turn set the scene for a protracted slump in prices. Trade diversion to the EC has had serious implications for the Philippines, Brazil, Cuba and the Dominican Republic. The Community now holds more than half the world's white sugar market and accounts for some 25 per cent of the total free market.

Producers in the African, Caribbean and Pacific (ACP) group of countries have been partially protected from these external effects by guaranteed quota access to the EC market under the terms of the Sugar Protocol attached to the Lome Convention. These exports to the EC, prices for which are linked to CAP intervention prices for sugar beet, are vital to the survival of the economies of several of the ACP states.

They are of particular importance to the relatively high-cost producers in the Caribbean, which would be uncompetitive in what has been a chronically depressed market for almost a decade. In Guyana, a country in which 75 per cent of the population live below the poverty line, the sugar industry accounts for 37.5 per cent of total export earnings and supports around 125,000 people.

Even in Mauritius, where state revenue from sugar exports to the EC has played a vital role in financing the emergence of a highly competitive textile industry, sugar still accounts for approximately 79 per cent of total net

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1 The information given in this section is taken from *The Report of a CIIR Seminar: Reform of the EC Sugar Regime: Implications for Developing Countries*, CIIR, November, 1992.

foreign exchange earnings. The EC has not aided this diversification process. In 1979 it imposed a 'voluntary export' restraint agreement on Mauritius, because her 1.4 per cent of EC clothing imports were seen as a threat.

This example from Mauritius gives some indication of the difficulties of diversification in the ACP sugar exports. It points to why it is vital that the EC honour the Maastricht commitment to foster the smooth and gradual integration of the developing countries into the world economy.

Likely Reforms

Proposals for the reform of the EC sugar regime were expected from the EC Commission in September 1992, for implementation in July 1993. In January 1993 it was decided to roll over the existing regime for one year. Agreement must be reached by the EC Council of Ministers by 1 January 1994.

Given the nature of the reforms agreed for the CAP in May 1992, price cuts are a likely outcome of the review, threatening the viability of the Sugar Protocol. Sugar beet is a major arable rotational crop, the effective support price for which is now substantially above that for cereals, leading to some pressure for sugar beet price cuts. With a GATT agreement, price cuts can be expected to be larger, probably in the region of 12-20 per cent.

According to Mr Stendevad, Head of the Sugar Division in DGVI, there is a 'limited risk of compensation' for price cuts and, without compensation for EC producers, there will be no direct compensation for price cuts for ACP suppliers. While superficially this may appear even handed, it obscures the different realities which face the two sets of producers.

Although EC farmers may not receive any direct compensation for changes in the sugar regime, they are nevertheless receiving an overall package of compensatory payments for changes to the CAP agreed in May 1992. The intention of this compensation is to ensure that they stay in business and continue to prosper.

Recommendations[1]

The aim of the sugar review should be to reduce sharply domestic production while protecting the interests of the ACP states signatory to the Sugar Protocol. To this end we propose the following measures:

- **Subsidised Exports: The withdrawal of price support for any sugar beet production in excess of domestic self-reliance minus the preferential imports provided by the ACP countries - equivalent to around 9.5 million tonnes. This reduction should be achieved over a five-year period through the abolition of B quota support and a 1.3 million tonne reduction in the A quota.**

- **Financial Aid for Diversification: The creation of a financial mechanism to compensate ACP exporters for price cuts introduced as a result either of CAP reform or a GATT Uruguay Round agreement. The aim of the mechanism should be to facilitate investment designed to raise the competitiveness**

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1 These recommendations were made by CIIR, Oxfam and Christian Aid in November 1992 in *The Report of a CIIR Seminar: Reform of the EC Sugar Regime: Implications for Developing Countries*.

of ACP industries, and promote diversification within the sugar industry and into other economic activities.

Any compensatory package should be made conditional on commitments by governments to implement programmes designed to protect the poorest and most vulnerable sugar producers from the effects of price cuts. This could be achieved through the participation of local trade unions, associations of agricultural producers and NGOs in the country concerned.

- Trade Restrictions: Urgent examination of trade restrictions the Community imposes through tariff escalation, quotas, minimum price controls and rules of origin criteria in sectors where ACP exporters enjoy a competitive advantage. We note with concern that, despite Lomè preferences, many Caribbean countries continue to find it easier to export horticultural products and textiles to the US markets than to the EC.

- Freight Costs: The creation of a freight assistance fund to compensate ACP exporters for the high transport costs incurred in supplying the EC market.

- The Portuguese Market: The extension of guaranteed price support to the 75,000 tonnes provided by the four ACP suppliers to Portugal (Cote d'Ivoire, Malawi, Swaziland, Zimbabwe); the addition of 45,000 tonnes to the ACP's guaranteed quota, the balance of 150,000 tonnes required by the Portuguese refining industry to be allocated on a preferential basis to Third World suppliers, giving special consideration to the position of Cuba in view of the losses it incurred following the extension of the common sugar regime to East Germany.

3. Cereals Sector[1]

Problems for the Third World

Around a quarter of EC cereals production is exported. Currently the EC pays farmers around $235 a tonne for wheat which it sells on the world market at approximately $120 ton.

The most visible victims are efficient agricultural exporters operating without the use of export subsidies. These include Third World exporters. For example, in the 1980s one of the most severely affected countries was Argentina. Prices for the cereals and oilseeds, which account for over half the country's export earnings, fell by 40 per cent between 1980 and 1987 because of export dumping by the United States and the European Community. Translated into financial terms, this wiped an estimated $3bn per annum off Argentina's foreign exchange earnings - equivalent to around half the country's debt service payments.

Peasant producers of staple foods in Third World cereal importing countries also suffer from EC cereals policy. Subsidised EC exports flood local food markets, depressing prices, reducing the household incomes of staple food producers and discouraging investment in agriculture. During 1986, for

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1 Kevin WATKINS: The examples contained in this section are taken from *Fixing the Rules: North-South issues in international trade and the GATT Uruguay Round*, CIIR, 1992.

instance, the United States and the European Community were selling wheat surpluses in west African countries such as Mali and Burkina Faso at prices as low as $60 a tonne - around a third lower than equivalent production, transport and marketing costs for locally produced cereals like sorghum and millet. In order to do so they were using direct and indirect subsidies of $100 a tonne to bridge the gap between domestic support and export prices. The result was a fall in rural household incomes (as cheap food imports depressed local staple prices), falling investment in agriculture and in some cases, migration from the land.

Recent Reforms

In the May 1992 CAP reforms the EC agreed to cut guaranteed cereal prices by 29 per cent over three years and to compensate growers on the basis of average regional yields.

The reform was heralded as the most radical overhaul of the CAP in its 30 year history. This is because the new compensation arrangements partially break the link between the support paid to farmers and the increasing amounts which price support incites them to produce.

However, the new arrangements still sustain the profit levels of the larger and more efficient grain producers at too high a level in relation to production cost to deter increased production, while they do not provide adequate curbs on increased production. This means that for the fifth of grain growers who produce 80 per cent of the Community's output, it will still be profitable to produce beyond the subsidy limit.[1]

It has therefore been estimated that, by the late 1990s, the EC will still produce nearly 25 per cent more wheat than in 1991 - and a commitment to subsidise the export of at least half its surplus.[2]

Further Reforms in Prospect

A GATT Uruguay Round agreement based on the Blair House accords will commit the EC to a reduction in the volume of subsidised exports by 21 per cent relative to the average of exports in 1986-90, by the year 1999 (or six years from the beginning of the agreement).

Given that the EC is likely to continue to maintain a very high level of production of wheat and other cereals despite the reforms of May last year, it is unlikely that it will be able to conform to the subsidised export limitation without further reforms. The Community will therefore be forced to either: 1) cut its prices so as to eliminate the need to subsidise exports, or 11) cut its production so that its export potential does conform to the limits.

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1 It must be emphasised that for the basic average production (4.6 tonnes a hectare EC-12) there will be no reduction in return on the 1992 level; on this basis output the farmer is guaranteed the post-reform price plus the compensatory subsidy. These two elements added together equal the pre-reform support price. Thus continued over-payment for the basic supported 'quota' will subsidises increased production and export at the closer to world prices established under the new diminished price support regime. Brian GARDNER: The EC Animal Feed Sector 1993-98, Brian GARDNER, *Agra Europe Special* Report NO. 68.

2 Brian GARDNER: The EC Animal Feed Sector 1993-98, Brian GARDNER, *Agra Europe* Special Report No. 68.

However, the US has agreed that the Community's compensation payments to farmers included in the 1992 reform package are not production related and therefore not subject to reduction. If, therefore, the EC does go for option 1) while maintaining the compensation payments, the larger and most efficient cereals growers who produce at least 75% of the Community's grain will be capable of competing at a post-GATT world price. The agreement is therefore unlikely to do much to help the Third World.

Recommendations

- **The withdrawal of price support and other payments linked to levels of production in excess of Community demand.**

- **A Commitment to phase out, over a five-year period, all direct and indirect export subsidies.**

- **Support for less intensive, more sustainable forms of agricultural production in the EC, based on lower levels of output.**

(d) Conclusion

In recent years there has been a great deal of rhetoric in the developed world concerning its obligations to developing countries. Yet this submission has outlined how the EC's agricultural policies undermine the rural sector in Third World countries, while its textile and tariff policies prohibit the development of textile and agroprocessing sectors which are commonly regarded as the first step toward industrialisation. What we are seeking, therefore, is a similar improvement in the quality of EC policy, so that it actually matches the development policy rhetoric.

In order to institutionalise recognition within the Community of the contradictions between EC trade policy and the stated aims for development policy, it is essential that the Community establish appropriate monitoring mechanisms.

2. BEUC's SUBMISSION TO THE COMMITTEE ON EXTERNAL ECONOMIC RELATIONS OF THE EUROPEAN PARLIAMENT ON THE COMMISSION'S DISCUSSION PAPER "INTERNATIONAL ECONOMIC INTERDEPENDENCE", May 1993

(i) Introduction

In recent years, world economy has faced increasing interdependence, which has radically changed in degree and nature from both the qualitative and quantitative point of view. The globalisation of economic activity has concerned both goods and services.

Overall BEUC supports the main conclusions of the Commission's Discussion Paper. We favour a stable and open world economy where competition forces can play effectively. We also favour the progressive liberalisation of trade. But, in our view, it should be clearly recognised that the new context should also benefit the consumer. Economic issues have also gained in relative importance from the consumer point of view.

Today, consumer interests are not yet fully recognised by the different parties concerned. Moreover, economic analysis - both micro and macroeconomic - is too often incomplete and biased, since its models and estimations do not specifically include consumer interests. As a result, economic analysis underestimates - and even ignores - consumer welfare. In such a context, the consumer is rarely aware of the direct and indirect implications of international economic interdependence. The consumer usually has to pay for such implications.

Furthermore, consumer consultation at national, Community and international level is totally insufficient. Even if the economic analysis could face the above lacunae, the consumer voice is still not heard. Priority is given to enterprises facing strong external competition and to sectorial problems.

Therefore, BEUC strongly supports the view that consumer interests should be added in this global context, where all parties involved are called to play a new active role.

(ii) International trade and the consumer

From the consumer point of view, the first and more important aspect of international economic interdependence is foreign trade. In recent decades, we have witnessed a rapid expansion of world trade and radical changes in its relative composition and geographic distribution. Industrialised countries continue to dominate international trade activity.

On this point, BEUC recently called for an overhaul of EC trade policy. The conclusions of the NCC report on world trade[1], published in Mai 1993, are that EC trade policy is not geared to improving the well-being of consumers, but rather to protecting sectorial and other special interests.

We concluded that over the last decade the Community has become more protectionist in a more protectionist world and that this attitude has imposed significant costs on the Community's economy and on its consumers. Consumers pay

1 *International Trade: The Consumer Agenda*, National Consumer Council, May 1993.

for this protectionism through, for example, artificially high prices for cars, clothes, shoes, electronic goods and food.

We also stressed the need for much greater transparency and accountability in the way Community trade decisions are taken.[1] Important policy papers are not usually accessible to many interested parties, decisions are made behind closed doors and minutes of meetings are not made public. In addition, assessments of the costs and benefits of introducing trade policy measures to the Community are inadequate, and the interests of consumers largely ignored.

In our view, the Community should take the lead in moving to more liberal policies. It should also move to open up its trade policy decision-making processes to more public scrunity and debate.

The report sets out 23 specific recommendations for action at national, Community and international level, including the following:

- proper, open procedures for evaluating the likely impact of proposed trade measures, along the lines of the OECD checklist;

- EC anti-dumping and safeguard regulations changed to provide full access for consumer representatives to non-confidential information;

- an end to dubious Commission arrangements, such as the EC/Japan consensus on cars which works against consumer interests;

- new EC mechanisms to be set up to ensure that consumers' economic interests are effectively represented.

(iii) Concentration and the consumer

The recent proliferation of operations involving mergers and takeovers of enterprises in the majority of industrial sectors and in services has modified - often irreversibly - the structures of such markets, and has inevitably lead to new types of corporate behaviour. As the Discussion Paper pointed out, this phenomenon is more and more international, so that most countries are concerned.

The current economic analysis has mainly studied the supply viewpoint by underlining, for example, the different perspectives, strategies and opportunities offered by this new context to enterprises. However, this phenomenon has also clear implications for the consumer. Indeed, mergers and acquisitions can have positive effects - gains in efficiency - but also negative effects - creating or strengthening monopoly power. From this point of view, they can become an instrument aimed at reducing the number of competitors in a particular market, and this, under certain conditions, can induce an increase in prices and in profit margins. Mergers and acquisitions may also encourage collusion, this being all the more likely where the number of enterprises in a given market is limited.

More generally, this movement towards oligopolistic market structures, coupled with the creation of dominant positions by large multinationals, can, at the end, reduce the choice and increase the price offered to the consumer.

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[1] See also BEUC's press release (05/93) of 6 May 1993.

This new global context stimulates more and more new commercial strategies and trade policies, whose effects, from the consumer point of view, need to be analysed. In the near future, new forms of market segmentation and partition could be developed and they could represent one of the major obstacles to the free movement of goods and services.

Finally, in such a context, competition and trade policies are more and more strictly interrelated. Economic analysis should therefore develop new models and tools in order to fully take into account this fact.

(iv) Financial markets and the consumer

International economic interdependence also concerns financial markets. This relatively new aspect of international economic interdependence has not yet been analysed from the consumer point of view. In the EC, the free movement of capitals is effective as from 1st January 1993, for enterprises as well as for individuals.

In the first instance, we can state that the globalisation of financial markets should also bring clear benefits to consumers. They should be free to move and invest their financial capitals, particularly where market conditions are the most advantageous and attractive. However, little effort has been made so far in order to make financial markets fully transparent and thus really competitive. For the consumer, the information on these markets is too often not easily accessible, or accessible at too high costs.

Moreover, consumers can only really benefit from open financial markets if some supplementary conditions are respected - for example, if they are legally protected against the bankruptcy of financial institutions entitled to collect private savings or to invest money. International rules should therefore be fixed in order to open the financial markets to more effective competition, and to create a global environment where consumers are entitled to play a role.

(v) Conclusion

We welcome the Commission's Discussion Paper on international economic interdependence. Overall this paper analyses this new concept and its practical consequences which affect the world economy as a whole. Certain aspects of interdependence, such as foreign trade, foreign trade investment, globalisation of technology and financial markets, are therefore described in the light of the latest economic research, with particular attention on those related to areas of Community competence.

However, one major limit of the paper is the fact that no consideration is given to consumer interests. In our view, any evaluation of the implications of economic interdependence for both external policies and Community priorities should clearly include the consumer as an interested party. As a consequence, any assessment of the costs of inadequate policy responses should also be based on the direct and indirect costs borne by the consumer.

We strongly support the view that consumers should benefit from an open and stable world economy. Any economic analysis - both theoretical and empirical - should clearly include and evaluate the consumer interests. To this end, new economic concepts and tools should be elaborated.

Similarly, consumer information and consultation should be urgently improved at national, Community and international level. International trade is one concrete area where such improvements are imperative.

3. UNICE COMMENTS ON COMMUNITY COMMERCIAL POLICY AND ITS INSTRUMENTS

European business people have to operate in a world undergoing profound change with globalisation of markets and the emergence of ever sharper competition. If companies are to survive and fulfil their role as creators of jobs and wealth, their competitiveness must be improved relentlessly in the framework of intensifying international competition. In this context, the Community's commercial policy, which governs commercial relations between the Community and third countries, must:

- see that international trade rules are complied with by all trade partners,
- improve access to third-country markets,
- increase the stability of the environment in which companies operate,
- help to strengthen European competitiveness.

An open multilateral trading system, based on clear and efficient rules, is the essential complement to the internal market.

A strengthening of the GATT multilateral trading system and acceptance of its rules by the largest possible number of countries must be the first priority of the Community's commercial policy. According to estimates made by GATT economists, in 1992 the Community was the world's largest importer and exporter with around 20 % of world exports (by value and excluding intra-Community trade) and 21.5 % of world imports. The corresponding figures for the United States are 18 and 19 %, and for Japan 12 % and 8 %.

UNICE expects the Community to use its weight as the world'smajor trading partner to obtain a global and balanced conclusion of the Uruguay Round.

Such an outcome would help to stem protectionist tendencies worldwide, to limit discriminatory bilateral arrangements, and to restrict recourse to unilateral measures and managed trade. To this end, UNICE would like GATT to be developed into a multilateral trade organisation, the dispute settlement procedures to be unified and unilateral measures to be abandoned.

When the rules of international trade are not respected or when import surges threaten to cause serious economic disturbances, it is essential that the Community be able to defend its legitimate interests as rapidly and as effectively as its trading partners. To this end, it should not hesitate to use its commercial-policy instruments, within the framework of international obligations and procedures.

It must be possible to use all the instruments at its disposal when circumstances so justify, each instrument corresponding to a clearly defined specific situation. An imbalance can be seen in the way Community trade policy instruments are currently applied.

The new commercial-policy instrument, against illicit commercial practices, and the regulations on imports are only very rarely used.

The regulation against dumped or subsidised imports is the instrument most currently used and is applied essentially in cases of dumping. Its practical use has revealed procedural inadequacies which compromise the effectiveness of the instrument.

To remedy this unsatisfactory situation and to prevent any risk of an instrument being used wrongly instead of another, improvements designed to ensure greater transparency and more coherence between instruments should be made to the regulations in force. These could be introduced in the framework of implementation of the results of the Uruguay Round.

In April 1990 UNICE submitted specific proposals for improvements to the anti-dumping regulation. These are still valid and will have to be reviewed in the light of the results of the Uruguay Round. It is prepared to submit to the Commission suggestions of the same order for all commercial-policy instruments and measures, including revision of the Community's generalised system of preferences. A solution which brings an end to the existing disorder should also be found rapidly to the problem of national quantitative restrictions, in the framework of the internal market.

For UNICE, the *conditions for an effective Community commercial policy* are as follows:

- sufficient margin of manoeuvre for the executive to act rapidly, effectively and with a determination in line with its economic weight;

- coordinated and unified approach on the part of Member States vis-à-vis third countries and the political will to use the instruments at the Community's disposal when the situation so requires. Such an attitude would have a not inconsiderable dissuasive effect;

- possibility for Community industry to lodge complaints directly with the Commission for all instruments. This is not currently the case for safeguard measures. This situation should be brought to an end rapidly to prevent excessive recourse to other instruments;

- adoption of more precise and transparent procedures for commercial-policy instruments, based on objective criteria and reasonable deadlines for each stage of the procedure, including decision-making procedures. It is important to find appropriate provisions designed to prevent the absence of a Council decision standing in the way of adoption of measures which meet the above-mentioned requirements;

- obligation for Member States to justify their decisions and right for the plaintiff to know the arguments put forward, within the rules of confidentiality. Such a measure would help to limit the risk of political bargaining;

- sufficient human resources at the Commission to monitor and implement commercial policy and hold commercial negotiations with third countries. The Uruguay Round negotiations have revealed deficiencies of this kind, in particular with regard to services;

- genuine partnership with the business circles concerned with a view to defining the medium- and long-term objectives and priorities of Community commercial policy and its priorities, and to developing appropriate actions. UNICE wishes to be consulted on a systematic and on-going basis. Such consultation would have the advantage, among others, of identifying a consensus prior to negotiations with third countries, thereby strengthening Commmunity negotiating positions. It would also enable any sectors likely to be affected by liberalisation measures to take the necessary adjustment measures, as rapidly as possible and in cooperation with Community and national authorities.

Given the growing interdependence of policies and economies, it is no longer possible to pursue a commercial policy without taking into account developments in other areas such as foreign policy, competition, environment, etc. UNICE calls for the establishment of better coordination within the Commission between the different departments concerned in order to avoid the Community sending several messages to the outside world or recommending contradictory measures.

At international level, it is essential for the Community, in its contacts with its trading partners, to seek to strengthen macro-economic cooperation. European companies connot accept that sharp and uncontrolled exchange-rate fluctuations should be able to undermine almost overnight the benefits of long and difficult negotiations on market access, and the balances thus obtained.

UNICE will return to some of these points in more specific positions. These comments may be modified in the light of the results of the Uruguay Round.