

## The European Community and Japan: Bi(tri)lateral Trade in World Context

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This paper addresses the central issue of Europe's economic relations, past and future, with the rest of the world. It concentrates on the trilateral relationship between the EC, the USA, and Japan. The formerly communist countries of Eastern and Central Europe, including the independent states which have replaced the old Soviet Union, play a small role in world trade, and partly because of their low income levels, partly because the economic system under which they operated until a few years ago discouraged international trade. EFTA is small by comparison with the EC, and its trade patterns are in any case very similar to those of the Community.<sup>1</sup>

From 1 January 1993, furthermore, the EC and EFTA were linked together in the "European Economic Area" (EEA), which formalized and extended the de facto free trade regime that has governed trade between the two areas for many years. In using the EC as a proxy for Europe, then, we make a useful and reasonable simplification. The grounds for focusing on the relationships of the EC with the two other industrial giants are obvious: those relationships account for the bulk of the Community's extra-European trade, just as the three sides of the triangle account for the bulk of total world trade. EC trade with the developing world is quantitatively on a fairly small scale. But it is immensely important for a number of reasons. The basic facts of Europe's present position in world trade are set out in Tables 1 to 3.

Trade between developed countries is largely intra-industry trade, in which fairly similar goods are exchanged, a given country exporting cars, electrical appliances and metal products to its partners, and importing cars, electrical appliances and metal products from its partners. By contrast, most trade between developed and developing countries can be explained in terms of differences in factor endowments or conditions of production: labor-rich, low-technology countries

<sup>1</sup> This paper will use the word Community and the acronym EC to refer to both the European Community (pre-Maastricht era) and the European Union (post-Maastricht era).

trading labour-intensive, low-technology products like clothing and toys for capital-intensive or skill-intensive, higher-technology products like computers and cars from skill-rich and capital-rich advanced countries. It is one of the key features of the trade relationship between Japan and the rest of the industrial world that it involves inter-industry as well as intra-industry trade, and this helps us understand the tensions that affect the relationship.

Table 1  
European Communities (EC6, EC12) third country exports by product group, 1968-88  
(per cent)

	1968		1978		1988		
	EC6	EC12	EC6	EC12	EC6	EC12	
Chemicals		12.1	11.1	12.1	11.4	13.4	13.6
Other non-electric machinery			15.2	14.4	15.9	15.7	13.7 13.6
Other consumer goods			7.4	7.7	8.1	8.5	10.3 11.2
Automotive products	11.4		11.6	11.0	9.5	12.8	9.3
Other semi-manufacturers			8.7	9.3	9.4	11.0	9.4 9.3
Food	7.4	8.6	7.0	7.6	7.3	7.3	

Office machinery and telecommunications			4.5	4.3	4.1	3.8	5.4	5.3
Other transport equipment	3,7	4,5	3,8	4,6	3,6	5,2		
Electric machinery and apparatus		4,7	4,6	5,1	4,8	4,7	4,4	
Iron and steel	7,3	6,4	7,0	6,7	4,4	4,3		
Textiles	5,1	5,2	3,5	3,3	3,6	3,0		
Fuels	3,7	2,8	4,2	4,0	1,9	2,8		
Residual	0,9	1,2	1,7	2,0	2,3	2,6		
Clothing	1,7	1,9	1,5	1,6	2,1	2,2		
Power generating machinery	0,6	0,7	2,0	2,3	1,4	2,1		
Non-ferrous metals	2,6	2,8	1,6	1,5	1,7	1,6		
Raw materials	2,2	2,2	1,4	1,2	1,5	1,5		
Ores and minerals	0,8	0,7	0,6	0,5	0,5	0,7		
Total merchandise exports	100	100	100	100	100	100	100	

Source: GATT 1991 from UNSO, Comtrade database

### Symmetry and Asymmetry in the Trilateral Relationship

Trade between the USA and Japan was notoriously imbalanced throughout the 1980s, with the United States frequently reporting trade deficits in excess of \$100 billion, of which over half found a counterpart in the Japanese trade surplus with the United States. At times Japanese imports were about half Japanese exports, and vice versa for the USA. Meanwhile the EC as a whole had a current account surplus of just under 1 per cent of GNP from 1983 to 1993. The overall EC surplus was, of course, composed of a series of subtotals, with Germany running a consistent surplus while other EC states had deficits totaling less than the German surplus. The EC has, certainly, run a trade deficit with Japan, but the nature of the deficit is quite different from that of the corresponding American one. These deficits have been a fruitful source of controversy and misunderstanding, so it is worth pausing to clarify some important points of principle.

Table 2

European Communities (EC6, EC12) third country imports by product group, 1968-88 (per cent)

1968	1978	1988								
EC\$	EC12	EC6	EC12	EC6	EC12					
Fuels	18.0	17.9	26.5	28.1	12.2	12.8				
Office machinery and telecommunications					2.7	2.5	4.5	4.4	10.3	11.4
Food	21.6	22.6	15.8	15.6	11,0	10,0				
Other consumer goods			3.4	3.3	5.7	5.5	8,9	9,2		
Other semi-manufacturers			6.1	6.8	6.9	7.8	8.1	7.9		
Chemicals		5,2	4,7	5,9	4,9	8,1	6,6			
Raw materials		11,6	12,4	6,0	6,8	5,0	5,6			
Other non-electric machinery				4,9	4,1	4,3	3,9	5,5	5,4	
Automotive products			1,7	1,0	3,0	2,2	5,4	4,5		
Clothing	1,0	1,0	3,0	2,6	4,6	4,3				
Residual	1,6	1,2	2,4	2,1	3,5	3,9				
Electric machinery and apparatus				1,9	1,7	1,9	1,6	3,2	3,2	
Other transport equipment			2,6	3,3	2,3	3,3	2,3	3,2		
Non-ferrous metals			7,1	7,3	2,8	2,7	2,9	2,9		
Ores and minerals			8,6	6,1	3,5	3,5	2,6	2,8		
Textiles	1,9	2,0	2,5	2,2	2,7	2,6				
Iron and steel	1,9	1,9	2,2	1,9	2,4	2,1				
Power generating machinery			0,2	0,2	0,8	0,9	1,3	1,6		

Total merchandise imports 100      100      100      100      100      100

Source: GATT 1991 from UNSO, Comtrade database

A trade deficit represents an excess of consumption and investment over production, or an excess of investment over saving. A trade surplus represents precisely the reverse. It is possible on this basis to interpret the United States deficit with Japan as the natural outcome of interaction between a low-saving economy and a high-saving one, between a country that wants to spend a lot of money on defense without raising taxes and one that does not want to spend much money on defense at all. The Japanese sell cars to the United States and invest the dollars thus earned in US government bonds. To describe this as a "natural" outcome of differences in saving behavior is not to imply that there are no grounds for concern. On the contrary, such a process implies a sustained growth of United States debt to Japan, and ultimately a major readjustment or even financial crisis if the Japanese ever decide that they do not want to hold any more American assets. But to see the deficit, as do many American observers and especially many American politicians, simply as the result of 'unfair' Japanese practices or of American uncompetitiveness, is at best to miss a central macroeconomic point.

The European deficit with Japan is different though, because it is not an element within a greater deficit. Rather it is a specific deficit matched by a trade surplus with the rest of the world. The "natural" explanation for this pattern would be that Japan is a resource poor country which has to import natural resources, especially energy from the Middle East, and has to pay for these imports through exports to the EC as well as the USA. European politicians and observers are, however, as reluctant as their American counterparts to accept "natural" explanations of Japanese success in exporting manufactures, and are subjecting the Japanese phenomenon to even closer scrutiny.

The real problem which both the USA and the EC face is that Japanese imports, whether they contribute to overall balance of payments problems or not, are concentrated in particular sectors, namely cars and electronics. This brings us back to one of our earlier points. In contrast to the general pattern of trade between advanced economies, Japanese-ECUS trade is to a great extent based on inter-industry rather than intra-industry trade. Competitive pressures in intra-industry trade can be handled by a given enterprise through a relatively painless process of seeking a new niche in the same market. Japanese competition, by contrast, seems to require an all or nothing response, and to threaten the extinction of whole industries and therefore whole lines of technological development. The OECD forecasts that the macroeconomic imbalances will shrink sharply in the 1990s, but that the problem of industrial mix will remain.

Finally in this introductory section, it is increasingly inappropriate to think about world economic relations in terms of trade alone. Investment flows are becoming an increasingly important dimension of the world economy. Investment is harder to trace than trade, so we have a less reliable picture of world investment flows than of flows of imports and exports; but in general terms the pattern of world investment is similar to that of trade, with the biggest flows being among the developed countries rather than from the developed to the developing. Inevitably, given the overall balance of payments trends we have just noted, the outward flow of Japanese investment has been among the most marked, and most controversial, of the features of the "globalization of business."

It is these issues that set the agenda for the succeeding sections of this paper. First, this paper examines the institutional context of EC trade policy and assesses the real level of protection that policy has afforded. Then it examines the question of how "common" the policy has in fact been and how it has related to competition policy, devoting a special section to the Common Agricultural Policy (CAP). The next two sections come back round to the crucial trilateral issues outlined above, by focusing on two key manufacturing sectors electronics and cars. In shifting the perspective towards the future this paper focuses first at the concept of "strategic trade policy" and then at the special issues raised by the reform process that "1992" has brought, if it has, in Eastern Europe. It ends by posing two fundamental and interrelated questions. Has "1992" brought the European Community closer to the rest of the world? And what is the future position of Europe in the international division of labor?

The central argument of this paper is that to speak of a bilateral trade or economic relationship between the EC and Japan is a panacea given the relative importance of the United States in World trade, making the US, Japan, and EC that three actors that really matter as far as international trade is concerned, and that the EC, in order to cope with the situation of world trade interdependence will have to replace, and has already done so silently, its open borders policy proclamations found in the Treaty of Maastricht, with more realistic policies of strategic trade with bi(tri) lateral concerns, that are after all the only serious concerns for the future of EC trade, given the relative importance of Japan and the US and the relative non-importance of the rest of the world.

### The Framework of Trade Policy

The EC is part of the GATT (General Agreement on Tariffs and Trade) system. Though it is the member states, not the EC itself, that are the signatories of GATT, the Community negotiates as a single entity. The original Rome Treaty specified under Article 113 that by 1969 there should be a true common commercial policy with all trade barriers against third countries unified, while Article 115 provided an escape clause in allowing for the survival of national trade policies as long as the common policy stayed on the drawing board. In the event, the member states achieved the goal of a common tariff regime, but failed to unify other policies affecting trade, such as technical barriers, administrative restrictions and voluntary export restraints (VERs). In 1982 the Commission produced a list of national trade policy measures which it recognized as formal derogations from the common commercial policy. The Commission chose to ignore many other measures in the hope that the reality of a single market would eventually lead to their abandonment. Common tariff or no, tariff barriers are in practice of very limited significance. As much as 29 per cent of EC imports bear a tariff of 5 per cent or under, and 90 per cent pay under 15 per cent (GATT 1992, 263). What is perhaps more important than the height of tariffs is the fact that they are "bound" under GATT rules. All GATT members are bound not to raise tariffs on industrial products, and indeed are committed to a series of rounds of tariff cuts.

One of the unspoken aims of the "1992" Plan was to force the member states to accept the logic of having a single regime vis-a-vis the outside world, and it will in a sense be possible from 1993 to treat the EC as a single trading body. The GATT secretariat has already, in its series of reviews of trade policy by signatories, published a single report on the trade policy of 'the European Communities'. The EC joined its first international organization in 1992 (the UN Food and Agriculture Organization) as one entity. But member states are still jealous of their trade policy powers. A complex legal debate is going on about whether the European Commission is authorized to negotiate and the Council of Ministers to agree trade accords on behalf of individual member states, or whether the whole EC can only be bound if each individual state signs given agreements (Victor 1991, 65).

The EC Commission tends to argue that where there is Community competence only Community organs can act. Some member states insist that unless the EC Treaties specifically provide for Community agencies to act, member states must endorse any collective action. This is a minor technicality when all member states are agreed, but there is more than symbolism at issue when, by insisting on the need to sign separately, member states are reaffirming their ultimate right to act independently. The Uruguay Round of GATT led to more formal collective action by the EC-12 than previous rounds, in that the EC Commission was authorized to be the spokesman for the twelve member states. But the pattern of that authorization made for a certain rigidity. The EC's negotiators came to the conference table with a negotiating position that has already been hammered out in intra-EC deliberations, and this may make it difficult for them to make concessions.

The point has come out with particular clarity in relation to negotiations on agriculture, where the inflexibility of the EC's position was surely linked to the lack of an intra-EC consensus on the right direction to go in. Contrast this to the position of the US administration, which was given "fast track" negotiating authority by Congress to get the best deal it can, and then submitted it for ratification or rejection as a package. The member states of the EC are obliged under EC law to remove all mutual trade barriers. The EC itself bears the GATT obligation to offer "most favored nation" (MFN) treatment to all the other signatories of GATT, i.e., to eschew any kind of discrimination that might lead to suspicion of the formation of trade blocs. In fact it does not do so. The EC is embedded in a

web of preferential trade agreements which exploit various exception clauses in the GATT text to offer lower tariffs to its immediate neighbors, and to certain less developed countries with which it wants good diplomatic relations.

Exception clauses or no, doubts have been raised as to the compatibility with GATT of the EC's modes of circumvention of the MFN rules. Even the links with the EFTA zone left a GATT panel "unable to reach a conclusion" on the question of compatibility with the General Agreement (GATT 1991, 62). However, the EC has, by and large, respected "tariff binding," the other pillar of GATT. The crucial achievement of the EC on the internal plane was the solidity of the pledge that trade barriers inside the EC would never be increased. Forcing them down to zero was a way of signaling this intent with the maximum clarity. The GATT system has set itself the more modest aim of binding tariffs; that is, ensuring that they could only go down, never up. Like other trading powers, the EC has basically stuck to this bargain. Thus tariffs are not an instrument that European politicians can use at their discretion to favor selected interest groups. Both importers and home producers know that the current level of tariff is a ceiling offering the carrot of free market access to those producers who can be competitive at the given rates and the stick of free competition from outside to those who cannot (OECD 1988, 120). Agriculture apart, this just mentioned principle holds pretty well. But it leaves quite a lot of room for discretion on matters other than the basic tariff rates. Indeed just as the removal of tariffs caused the relative, sometimes even absolute, prominence of non-tariff barriers to rise within the EC, as governments intent on pursuing their own trade policy vis-a-vis the non-EC world found it necessary to erect barriers against the "deflection" of non-EC goods entering the Community through other member countries with different trade policies, so the GATT rules on tariff binding have induced an exploration at the Community's interface with the rest of the world of 'gray area' measures that do not violate GATT openly.

The Rome Treaty as well as the Maastricht Treaty have laid down that EC commercial policy was to be agreed by Qualified Majority Voting in the Council of Ministers, on proposals from the EC Commission, and then implemented by the Commission. A complex of committees was set up to oversee the activities of the Commission in this connection. There is considerable controversy over the way the Commission uses the powers that have been delegated to it by the Council of Ministers. Some British observers claim that the Commission has resorted to something akin to cunning to get its own way in the face of potential resistance from the Council of Ministers.

It must be said, however, that on the whole the Commission has to act within guidelines set by ministers. To the extent that it has room for maneuver, it uses it not to thwart any collective vision, but rather to exploit differences between member states and to choose which one of a number of possible compromises should prevail. As we shall see below, there is considerable debate about anti-dumping actions by the Commission, an area where it enjoys delegated executive power, but it seems that even here there is no general dissatisfaction in the Council of Ministers with the way the Commission is exercising its powers. If there were, the Council would, of course, have the power to instruct the Commission to alter its policy.

There is a complex hierarchy of preferential trade agreements affecting less developed countries. As far as advanced industrial countries are concerned, we can distinguish between intra-European relations and relations with Japan and the USA. As we saw earlier, the EC plus EFTA is effectively a free trade zone; it is also understood that formal non-tariff barriers are not applied between the EC and EFTA, though the EEA agreement does allow the invocation of emergency safeguard measures. In contrast, goods imported from Japan and the USA are subject to the full Common External Tariff and any other measures of trade policy the EC cares to impose.

### The Level of Protection

It is a paradox of the present trade policy debate that where special measures such as VERs or anti-dumping duties are not applied, EC trade policy is actually very liberal. Even for Japan and the USA, which do not benefit from any trade concessions beyond the standard GATT obligations, the operational rates of tariff are low. GATT estimated the simple average rate of tariff on industrial products at 6.4 per cent in 1988. There is relatively little deviation around this average. Even for sensitive sectors tariffs are modest: cars bear an average tariff rate of 10 per cent (though some

vehicles bear 22 per cent), and textiles and clothing tariffs go from 0 per cent to 17 per cent. Photographic and optical goods carry an average of about 7 per cent. These figures reinforce the view that tariff barriers and their removal are not the most significant element in world trade today.

The standard deviation in 1988 across all EC industrial tariffs was 2.6 per cent. This is important, as it is the differences between tariff rates that determine how much the protective system is altering the direction of economic activity. If some industries have heavy protection and others little, there is an incentive for resources to move into or stay in some sectors rather than others. If, by contrast, all industrial goods were protected equally, then no one industry would benefit relative to others. There are, indeed, some trade restrictions which affect individual sectors very strongly, and without which it is hard to imagine investment taking place within the EC in these sectors, but such measures are usually other than the conventional tariff which figures in the trade textbooks. Non-tariff barriers apart, the most important forms of "extraordinary" protection are "safeguard" and "anti-dumping" tariffs.

Broadly speaking the USA is not subject to trade restrictions other than the regular tariffs in relation to its exports to the EC. The exceptions, and the main bones of contention on trade between the EC and the USA, concern agricultural products and a very limited number of high-tech products. Japanese imports into the EC are in principle treated on the same basis as imports from the USA. The rapid rise of EC imports from Japan in certain very sensitive areas, however, combined with the recession conditions of the 1980s, has led to considerable pressure on the Japanese to 'moderate' their exports to the EC. So far these measures have been negotiated, sometimes tacitly, between the Japanese and individual member states. This was the case before 1993 and was no longer be feasible after 1993.

#### Obstacles to a Common Policy

Let us return to the issue of "trade deflection" and Article 115. Where a member state has a national barrier to external imports recognized under EC law, and if trade deflection via member states that do not have such barriers is causing "disruption," the member state in question may at present apply to the EC Commission for permission to impose controls on extra-EC imports as they come in across the intra-EC border. Italy, for example, has exercised the right to stop Japanese cars coming in via France. The most striking use of Article 115 has been in relation to imports of textiles and clothing from less developed and industrializing countries over a period of some thirty years. Under the rubric of "Multifibre Arrangements" (MFAs) lasting four to five years each, the main exporting and importing countries sign a series of bilateral voluntary export restraint agreements. These are totally against the principles of GATT, and in order to preserve a facade of legality a special set of exceptional rules have been laid down to govern the quotas.

The cost to consumers in the developed countries is high. The World Bank (1987, 152) cites estimates ranging from \$1.4 billion to \$6.6 billion for the cost to EC consumers of having to buy textiles and clothing from more expensive sources. Nor is there any evidence that this kind of protection saves jobs. The OECD (1985) notes that in textiles and clothing, as well as in the highly protected iron and steel sector, job losses have continued unabated despite protection. This is partly because restricting imports to keep up prices not only permits the survival of old-fashioned, inefficient firms, but also facilitates the entry of new, more efficient domestic firms. This new entry ultimately drives out the weaklings just as surely as import competition.

In the context of the MFA what this means is that inefficient clothing firms in the North of England cannot be protected as long as the UK is part of a customs union, since Italian firms can replace imports from outside the EC. In fact, this is not as high a "cost" as it seems. The pressure of competition from Italian firms forces UK clothing firms to become more efficient. On the other hand, the higher prices permitted by protection may promote new investment even from local sources, and so induce excess capacity. The problem is, of course, further intensified when foreign investors from the extra-EC exporting countries can set up plants behind the protective walls too.

Producers are not easily convinced of the proposition that cutting out one source of competition may simply lead to its replacement by another, so they often plead for the use of intra-EC border measures to segregate national markets against third country competition. Many writers (Hindley 1988, 50) are

very concerned about the way that the EC Commission is increasingly invoking anti-dumping duties in areas where national measures were previously in force. Anti-dumping duties were originally developed at the turn of the century to guard against "predatory pricing," whereby a potential monopolist could undercut newer smaller rivals in order to corner a market. It is widely agreed (Ordoover and Saloner 1989, 132) that a special set of rules that go beyond normal anti-trust regulations may be needed for imports.

The reason is that it is very expensive for a big firm to engage in predatory price cutting against a small rival, if it is operating in a single geographical territory. The small firm can retaliate against the big firm's home sales base, and the big firm cannot easily confine its price discounts to customers who might be thinking of switching to the new firm. In contrast, where the 'attacking' firm is in a separate country and its home market is protected by tariffs, it is possible to cut prices selectively without suffering either retaliation or loss of home base sales. Thus predatory dumping to capture a world market, and certain other forms of related "unfair trade practice" often relating to subsidies, are indeed real possibilities. However, most analysts (Stegemann 1991) have concluded that there has been widespread abuse of the anti-dumping rules.

GATT permits two forms of contingency measure. Article XIX allows countries suffering a sudden and unforeseen "surge" of imports to take emergency safeguard measures. But the conditions for doing this are tightly circumscribed, and "compensation" may have to be offered to injured parties. This puts the country using Article XIX measures in the dock as a violator of GATT, so countries prefer to use Article VI, which permits the use of anti-dumping duties where an exporter is gaining in market share "unfairly," by selling below his normal price on the home market. The EC Council of Ministers has laid down very complex regulations governing the way the Commission imposes anti-dumping duties.

First, sales below "normal" price must be proven, and then injury must be proved. Even then, the 'Community interest' has to be considered before duties are actually imposed. Considerable discretion exists at each step in the calculation. Critics argue (Schuknecht 1991) that it is always exercised in a protectionist way. For example, comparing export prices with 'normal' home prices involves an averaging process. Any home sales below full cost will be treated as abnormal and excluded from the calculation, while any export prices above normal price will be excluded because "negative dumping" is impossible. The calculation of injury is always dependent on data supplied by the injured party, and the Commission uses informal judgment rather than independent analysis to decide whether loss of intra-EC market share is due to "unfair" competition. The analysis of Community interest is based on the proposition that the best interests of users and consumers alike are served by the existence of a "viable community industry," an argument that is, to say the least, controversial.

The Commission has been extremely active in using anti-dumping procedures, particularly in the electronics field and especially against Japan, the NICs and Eastern Europe. Member states have in the past been prepared to use voluntary export restraints as a way of extending the range of restriction on imports from Japan and Korea beyond the coverage of the MFA. However, these risk violating GATT and represent a violation of the Rome Treaty's competition rules as well. The practice has developed among well-organized industries, faced with strong import competition, of seeking government approval for "industry-to-industry" agreements to limit sales. "Approval" means that the government may tacitly threaten use of Article XIX measures against the foreign industry, or may just turn blind eye. Under Japanese law, the Fair Trade Commission can permit limitations on exports if there would otherwise be a threat of trade policy intervention (GATT 1990).

For example the Japanese have agreed with the British car industry to take no more than 11 per cent of the UK market. Where agreements like this are made between governments, GATT rules are violated, but the only people who can complain are the other governments, who are not, of course, going to. Where firms or trade associations meet to do deals restricting sales or raising prices, they are in fact forming a cartel. A series of decisions and court cases under Article 85 of the Rome Treaty (Bourgeois 1989) has made it very clear that such practices are illegal. The first such case arose when French and Japanese ball bearing manufacturers agreed to share the French market.

Anti-dumping actions and VERs carry an importance that goes far beyond their immediate impact. They create disincentives to investment in export success, since they imply that export success may be stymied by European trade barriers; and they create uncertainty for exporters, as they are applied with a high degree of discretion. Outright cartelisation apart, both anti-dumping measures and voluntary export restrictions are likely to have significantly anti-competitive effects. As Patrick Messerlin (1991, 232) has argued, if a price-cutting firm is threatened with anti-dumping action by its less aggressive

rivals, there is a clear incentive for all the firms to get together to agree prices that are mutually satisfactory, if less satisfactory for consumers. Export restraints have two kinds of anti-competitive effect: by limiting sales from restrained firms, they reduce the competitive pressure on other firms and by requiring market sharing arrangements to be set up by the exporting firms, they make entry of new firms in the exporting country more difficult.

Restrictions on direct imports do, of course, have the perverse effect of attracting inward investment that neutralizes the protection. There is, certainly, some disagreement as to how far Japanese inward investments are stimulated by actual or threatened EC protectionism. Thomsen and Nicolaides (1990, 40) argue that globalization of production is a natural process involving all firms including the Japanese. But other writers (Belderbos 1992, 43) suggest that EC trade policy has been an important factor. In the 1960s many governments were willing to restrict inward investment as well as trade, but considerations of employment and technological conditions make this unrealistic today. Globalization, whatever its roots, creates a whole new complex of interrelated trade and competition issues, which we treat in the next section.

### Trade Policy and Competition

In an increasingly globalized market it becomes more and more difficult to sustain the view that competition from non-EC-owned firms or non-EC-located production should be regulated differently from wholly indigenous production. Robert Reich (1990) asks 'Who is "us"?' An increasing proportion of EC-based production is by foreign-owned firms, while EC-owned firms produce more and more abroad. An integrated world market probably brings more technology transfer. And if there are problems of global unfair competition they can be dealt with only by world-wide antitrust agreements (Hansen 1992, 142). The internationalization of business may, in fact, have a major impact on the way the business world on balance views the benefits of protection. Schuknecht (1994, 30) interprets the commitment to an open trade policy within the EC as essentially a triumph of political and economic interests with an export orientation over those more interested in protection against imports. Milner (1988, 76) has shown that multinational firms may well lobby for free trade rather than protection.

However, some of the same incentives to take the edge of competition that exist in a national oligopoly situation also exist on a global scale. The European Community, in a recent statement of principles on industrial and trade policy (EC Commission 1994), has argued that free external competition is a necessary counterpart of a free internal market. However, there are important and difficult issues to face in certain sectors where economies of scale are so large that there may be room only for a very small number of firms in the EC. Merger policy must take trade and technology issues into account. On the whole it seems sensible to argue that we can be more lax about permitting mergers the more open the EC market is. But there does come a point where we must start worrying about global oligopolies, which may form "strategic alliances," sometimes ostensibly to imitate Japanese keiretsu (interlinked) firms. The head of the German Federal cartel office, W. Kartte, has warned that "strategic alliances" are often tantamount to private market orders, which necessarily lead to distortions of the world economy' (Hansen 1991, 215; Holmes 1991). We do therefore need to be vigilant about unfair competition, but not in an oversimplified way that sees all external competition as harmful.

### The Common Agricultural Policy

It is certainly the trade effects of the Common Agricultural Policy that have contributed most to the Community's protectionist image. It is fair to add, however, that the Community inherited national traditions of protecting agriculture, traditions found in other developed countries in equal measure, and simply merged them into the CAP. The CAP attracts particular attention, first because the sheer size of the Community's agricultural trade gives it a major influence on world markets. As the Community limits imports, for example, by imposing levies to bring import prices up to levels at which European farmers can compete, the effect is to depress prices on world markets. Anderson and Tyers (1986)



found that the effects of the EC's farm policies on world markets were much bigger in every sector that they studied than the effects of other countries' policies, with the single exception of the rice market, where Japanese import restrictions have indeed a greater impact than the CAP. It is also worth noting that the effects of the CAP are not just on the level of world prices, but also on their variability: guaranteed prices insulate European farmers and consumers from the low prices that obtain in years of plenty, so ensuring that the European market plays no part in absorbing the plenty and implying a bigger price reduction in the rest of the world.

The second feature of the CAP that has brought it into the international spotlight is its "success" in generating European self-sufficiency through high farm prices. In the early 1960s the Community covered around 90 per cent of its agricultural consumption with own production; by the mid-1980s, according to Anderson and Tyers (1986), it was producing around 105 per cent of its consumption. Keeping up the price of an imported good requires an import tax, whose impact on the level of consumer prices may not be visible to the average citizen, and which contributes positively to budget revenue. Keeping up the price of an exported good requires budgetary expenditure to cover buying the product at the high European price and selling it at the lower world price. As the costs of the CAP have started to appear on the EC budget as well as on consumer budgets, the Community has become more concerned to contain those costs. More important in the present context, as the CAP has constrained the EC to off load its surpluses on to world markets, the costs to farmers outside the Community have become more apparent, and the US, in particular, has become more militant in its demands for CAP reform.

Although the CAP has ill effects on developing countries, especially in relation to the sugar market,<sup>2</sup> it is other developed countries that, together with European consumers, incur the greatest costs. The CAP has its biggest impact on temperate products, such as beef, lamb, dairy products, sugar beet and grains; it is the interests of exporters of these products in Australia, New Zealand and North America which are most affected. The extent of the problem that the CAP creates for the world trading system is clearly indicated by the obstacles that it placed in the way of the Uruguay Round of trade negotiations in the period from 1986 to 1994. The Community has been faced with determined pressure from the United States, not itself particularly committed to freer agricultural trade as such but concerned about the increasing competition it faces on world markets from the EC's surpluses, and from the Cairns group of countries, including Australia, whose clear interest as temperate zone agricultural exporters is in freer trade. It continues to defend a policy that imposes great costs on European consumers, increasing costs on the Community budget, and has threatened to scupper a set of trade negotiations in the success of which the Community has a vital interest. Faced with all of these considerations, the EC has been reluctant, to the point of intransigence, to embrace the case for reform.

## The Electronics Industry

Many of the points that arose in the discussion of commercial policy can be illustrated by the experience of the electronics industry. The most striking development in this sector is the rise of Japanese firms over the last ten to twenty years. They have moved from being major producers of consumer electronics products in the 1970s to the position of dominant producers in this area and in certain components fields. EC industry has lobbied intensely for support in this connection. Since the early 1980s the EC has put in place a series of programs for intra-EC industrial collaboration, but these initiatives have merely served to confirm that here more than anywhere, in the context of a rapidly evolving structure in the industry, trade, competition and technology policy must be integrated. The Commission has responded to lobbying by embarked on a series of antidumping actions in virtually all the areas where Asian producers have been successful color TVs, CD players, audio tapes, VCRs. There are strong grounds for querying whether that this kind of

<sup>2</sup> Sugar is an unusual product in that it is produced in two quite different ways in temperate and tropical climates.

protection can work (Cawson and Holmes 1992, 45). The most obvious one is that since the late 1980s Japanese, Taiwanese and Korean firms, and even one Chinese TV firm have been investing heavily

inside the EC to take advantage of the artificially high prices produced by the anti-dumping duties. The cost to consumers has been considerable, but the gain to EC-owned firms has been minimal. Indeed the latter have almost certainly lost something from the false sense of security arising from the notion that they could afford to delay entry into new product lines.

Technological protection through ingenious technical standards does not work either. The new MAC TV standard, for example, is unlikely to be of great benefit for EC industry. Even if it proves to be exactly what EC consumers want, there is no way of ensuring that Asian firms do not simply invest first. If they do, there is no legal way to prevent these firms having access to the entire EC (plus EFTA) market. The EC Commission has tried to impose "local content requirements" in some cases. This means that electronic products made in foreign-owned factories using imported components may find import restrictions that apply to the relevant finished product being imposed on them as they emerge from the factory. But an EC regulation covering the levying of anti-dumping duties on so-called screwdriver plants making electronics goods has been condemned by GATT. The EC Commission has stated that it will keep this regulation on its books until a new GATT anti-dumping code is agreed, but observers agree that the regulation cannot be used in practice (EC Commission 1991b, 23).

There is considerable evidence (Porter 1991, 23) that the success of Japanese consumer electronics may depend as much on fierce internal competition as on any exclusion of foreign firms or "unfair" trading practice. EC commentators (EC Commission 1991a) may have more grounds for concern in relation to the electronic components industry. Plausible complaints of dumping have been made with respect to semi-conductors. The Japanese stand accused by the USA and the EC of subsidizing production of DRAM memory chips, and thus collectively gaining a near monopoly. This probably represents the most acute challenge there has been to the principle of free trade. Here is a sector where most commentators (Flamm 1991, 120) accept that Japanese success has been significantly affected by government policies.

European fares were never very significant in the sector, but the 1980s saw a retreat by US firms from the memory market, with a 90 per cent share going to Japanese firms according to the EC Commission (1991a). It is no less worrying that in the even more strategic sector of microprocessors two US firms, Intel and Motorola, hold 85 per cent of the world market. It is frankly not at all clear what trade policy can do about this. Selective public procurement led in the past to the promotion of "national champions" which tended to develop the mentality of defense contractors. There may be a theoretical case for strategic trade policies in such cases. But where the leading EC-based electronics firms are Japanese, there may be more of a case for focusing on the articulation of a binding international code on monopoly and restrictive oligopolistic practices.

Another sector where this kind of problem is likely to arise acutely is telecommunications, where once again globalization of business means that trade, telecommunications and technology policy issues meet. In the past telecommunications equipment was supplied by 'clubs' of producers to state telecommunications monopolies which could pass on high prices and low quality to captive customers. For better or worse, the utilities are now privatized and on the lookout for the cheapest equipment available. The high Research and Development (R&D) costs of telecommunications equipment mean that in this industry there is always a temptation to subsidize in order to ensure that exports are offered at (low) marginal cost. The liberalization and privatization of intra-EC public procurement raises the question of what will happen if the cheapest supplier is not from another EC state but from the USA or Japan, where huge economies of scale do, indeed, permit sales abroad at lower prices. As with semi-conductors, there is a genuine possibility of unfair competition, and plenty of scope for the interests of users and producers to clash.

In all, these policy areas relating to electronics the member states of the EC have pursued rather divergent policies in the past. It is a major challenge to produce a common set of policies that are coherent on all the dimensions involved:

1. across the fifteen member states
2. between trade, competition and technology fields
3. across the different elements of the industry (protecting chips production, for example, hurts computer firms).

The Car Industry

The European automotive industry provides a good Case-study of European Community trade policy-making. The elimination of non-tariff barriers, as part of the "1992" process, has major implications for external trade policy where different countries have had different external policies. As a result, the Community's institutions are facing major political and economic difficulties as they confront the implications of the single market program for the vehicle market.

The car market in Europe shows strong patterns of national preference: the two French producer groups, which have 23 per cent of the EC market, take 60 per cent of the French market and 34 per cent of the Spanish market; Fiat has over 50 per cent of the Italian market, while the UK market is dominated by the US multinationals. The asymmetric pattern of market shares means that some producers are dependent on a limited number of national markets for most of their sales: Fiat makes two-thirds of its Western European car sales in Italy alone, while the two French groups are very dependent on the French and Spanish markets.

Further, a number of EC markets have been subject to restrictions on imports of Japanese cars. In 1977 the Japanese producers agreed a voluntary export restriction with the UK industry, with the connivance and encouragement of the UK government, under which they committed themselves to hold their imports to a share of 11 per cent of the UK market. In France, the Japanese import share is fixed at 3 per cent, by an agreement between the French government and the Japanese producers; while in Italy, Spain and Portugal, Japanese car imports are held to even lower levels through quotas. In the Italian case, a bilateral quota of just 3,000 vehicles was agreed with the Japanese as early as the early 1960s. By contrast, the Japanese market share in the essentially unrestricted German market was 16 per cent in 1990, and averaged 24 per cent in the EC countries other than those specified above in the same year. Restrictions on imports inevitably impose costs on consumers, because they raise prices. In this case, European producers' market shares are increased, and the combined effect of higher prices and larger shares clearly benefits these producers. Since, however, the principal effect on prices is to raise the prices of Japanese cars, there are benefits to Japanese producers too, to set against their loss of market share. Import restrictions also have subtler effects on the nature of competition in the car market. When Japanese firms face import restrictions, European firms know that an important group of their competitors face limitations on their ability to compete. European firms can therefore set prices that much higher than if they had to worry about their Japanese competitors cutting prices to increase sales. Also, the fact that many of the import restrictions are administered by the Japanese industry acts as a barrier to the entry of new Japanese firms. Thus quantitative restriction on imports is inherently anti-competitive in its implications.

Technically speaking, the planned abolition, after "1992," of Article 115 has limited application to the car market, since the French and UK restrictions on Japanese imports are "gray area" measures, that is to say, they are not trade restrictions officially recognized by the European Commission as derogations. Their existence has therefore not been dependent on Article 115 support. Nevertheless, national restrictions on Japanese car imports have to be supported by mechanisms which have the same effect as Article 115 border restrictions. A French car-buyer who attempts to circumvent the restrictions on Japanese car imports by buying a car in Germany, for example, would encounter considerable bureaucratic obstacles to registering the car in France.

The opening up of the French, Spanish and Italian markets to unrestricted Japanese imports would clearly cause great problems for European car-makers, especially for the French and Italian producers who have large shares in these markets. To add to the difficulties about arriving at a European policy on car imports from Japan, the role of the Japanese firms within the European market is rapidly changing as "transplant" operations are established. Nissan's plant in England has been functioning since 1988. Toyota and Honda are due to open plants in England in 1992: there are significant Japanese investments in other EC countries, including Spain. The European Commission estimates that the capacity of these transplants will be around 1.2 million cars by the end of 1999, while the UK government is reported to estimate a figure of 2 million (Financial Times 1991b). Clearly, if cars produced in Europe by Japanese firms are treated as EC-produced cars, and legally they are entitled to such treatment under Articles 9 and 10 of the Treaty of Maastricht, then the Japanese transplant operations can ultimately get around any European import restrictions.

In the face of all of these difficulties, it is perhaps unsurprising that it took two years of difficult negotiations within the Community, and then between the Community and the Japanese, to arrive at a

post-1992 policy. Agreement with the Japanese was reached at the end of July 1991 (Financial Times 1991 c). The agreement has four main components:

1. Intra-EC trade will be liberalized by the adoption of an EC-type approval scheme by 1 January 1993, and all national import restrictions will be abolished by the same date.
2. Imports of cars from Japan will be unrestricted after 31 December 1999, and in the intervening period will be limited to the level of 1.23 million (approximately the current level of imports).
3. Cars produced in Japanese-owned plants in the EC will have unrestricted access to the EC market.
4. There is an understanding about the levels of Japanese imports into France, Italy, Spain, Portugal and the UK from which it can be inferred that a deliberate attempt will be made by Japanese firms to reduce adjustment pressures in the markets from which national import restrictions have been removed. On the face of it, this agreement provided a nice compromise between the competing pressures on the Community, on the one hand to fulfill its promises about the "common market" and on the other to safeguard the interests of a key industry. It seems to imply a considerable liberalization of the market, since the combined effect of imports and transplants should be to double the Japanese share of the EC market in the medium term, and since full liberalization is promised for the year 2000. There are some unresolved difficulties, however.

Let us begin with the proposed provision for "restraint" in the five currently restricted markets. If the announced levels of expected imports into these markets are purely forecasts, then it is not clear that they have much real meaning. Assuming that Japanese firms avoid deliberate attempts to exceed the forecast levels of sales, are there going to be measures to discourage French car-buyers, for example, from buying cars in Germany? If so, then we shall effectively be keeping some kind of market-segmenting non-tariff barriers to intra-EC trade, and not fulfilling the promise of 1992 until 2000. Even more important is the problem raised by the transplants: the European Commission stipulated the import limit of 1.23 million in the expectation that transplant output would reach 1.2 million by the end of 1999. What has been agreed is that transplant output will be treated, in accordance with Article 9 of the Treaty of Maastricht, as EC goods entitled to free circulation within the Community. However, there is no agreement on what should be done if the estimated transplant output of 1.2 million turns out to be inaccurate. In the light of the possibility that the actual level of transplant output might be as high as 2 million, this could be a critical issue.

If transplant output rises faster than the EC expects, then either it will have to accept a still larger Japanese share of the EC market, or it will have to seek to persuade the Japanese to reduce their imports below the agreed level of 1.23 million. The first alternative would be politically and economically uncomfortable, and would make the import restriction irrelevant; while the second would imply that the EC-produced cars are in fact included in an overall sales restriction on Japanese cars, which would imply in turn a very significant departure from a central principle of the Community, namely the free circulation of goods.

A further, possibly minor but none the less interesting, twist is introduced by the existence of Japanese-owned transplants in the United States. Several Japanese producers are now producing in the USA on a very large scale. Honda cars are exported from the USA to Japan, and Honda has repeatedly announced its intention of exporting US-built cars to the EC. There can be no question of the imposition of a restriction on such imports. US-made Hondas are American cars, not Japanese cars, so far as the normal rules of international trade are concerned. The US government would object strongly and successfully to any attempt to impose restraints, direct or indirect, on their export to Europe. Nevertheless, imports from the United States could be influenced by the existence of the import restriction on Japanese-made cars. If the Japanese firm believe that rapid growth of sales from North America will lead to tighter 'monitoring' of imports from Japan, then that belief could itself lead to sales restraint without the need for any explicit statement by the Community.

This leads to the disturbing conclusion that voluntary export restrictions always partake of the character of government encouraged market-sharing arrangements, whatever their form, whatever the level at which they are imposed. As the European Commission seeks to "monitor" the sales of "Japanese" cars in the Community, it has to take account of transplant output if the monitoring is to be effective. The device of "forecasting" transplant output before arriving at the guidelines for direct imports from Japan helps to make it appear as if transplant output is not subject to any restriction; but in reality Japanese producers are likely to expect that attempts will be made to cut back on their import quotas if their transplant output rises by more than expected. Thus Nissan, Honda, Toyota and all other Japanese producers will receive signals as to what are their respective 'acceptable' shares of the

European market. Such market sharing removes any incentive for them to compete with each other, reduces the competitive pressure on non-Japanese firms, and makes it harder for new entrants to the market. All of these effects run counter to the provisions of Article 85 of the Treaty of Rome.

The ultimate objective of European policy towards the car industry should be to help European producers become more competitive. Comparative studies of car plants in Japan, the USA and Europe have exposed the vast productivity gap between European producers and their competitors. According to Jones et al. (1990), European plants seem to require on average twice the labor input per car that Japanese plants need. In addition, European producers lag far behind Japanese in reliability and consumer satisfaction. Protection has not so far been effective in raising European competitiveness, and this makes it difficult to believe that another seven or eight years of protection will do any better. It is much more plausible to argue that open competition with the Japanese is the incentive that the industry needs to improve its performance. There is evidence from the United States to back up this view: American producers have narrowed the productivity gap with the Japanese as their market has become more and more exposed to Japanese competition. It is high time European producers were subjected to the same discipline.

### Issues of Strategic Trade

Much of European trade policy seems concerned with keeping European industry competitive with the Japanese and the Americans, in areas such as consumer electronics, aircraft, cars and computers. Governments often seem to take it as self-evident that special efforts should be made to attain or maintain competitiveness in such sectors. Can this attitude be justified? Or would we do better simply to let the free market determine where we fit in to the world division of labor? The simplest justification for active trade policy is based on the proposition that the countries and regions which specialize in the production of such high-tech products are better off than those that produce more traditional products. Thus California is richer than Pennsylvania, Japan than China. But this simplistic argument begs the question of what is cause and what effect. Highly skilled and highly educated labor certainly commands much higher rewards in the world market than unskilled and uneducated labor, and is certainly used in high-technology industries. It is equally clear, however, that the artificial fostering of high-technology development is unlikely in itself to create a self-sustaining high-wage economy.

But that is not the end of the story. Paul Krugman (1992) draws our attention to the fact that highly skilled American labor concentrates in California, and on the northeastern seaboard, even though the American education system is of reasonably uniform quality throughout the country and labor is both free to move and, by European standards, remarkably willing to move across all parts of the country. The concentration of the American microelectronics industry in one particular part of California and one particular part of Massachusetts is strongly suggestive that there are gains to producers from proximity to other producers in the same or related lines of business. Belief in such "positive externalities" provides one justification for seeking to promote or protect particular activities. A rather different argument in favor of interventionist policy was presented by Brander and Spencer (1986), who proposed a model in which government assistance to its national champion firm could persuade the champion's rivals to sell less aggressively and thus let the national champion have a disproportionate share of a supposedly profitable market. The simplest illustration of this argument is provided by a story about the aircraft market. Suppose some sector of the market is marginally unprofitable if two producers enter, but very profitable for a single producer. Only one will enter, but which one? A government subsidy to one firm, just large enough so that it is marginally profitable for the firm to enter even in the presence of a rival, will ensure that firm does, indeed, enter. But then the unsubsidized rival will not, and at a small cost the government has ensured that its champion grabs the profits!

Many observers see in the success of Japanese industrial policy evidence in support of the idea that there are strategic sectors which policy intervention can promote in the national interest. The problem is not so much in accepting that intervention in Japan (and in Korea and Taiwan, also) has been remarkably successful, as in identifying what it is about East Asian industrial policies that has made

them so much more successful than industrial interventionism in South Asia or South America. There may well be lessons to be learned by Europe, but it is unfortunately not quite obvious what the lessons are.

### The Structural Impediments Initiative

As we saw earlier, both the United States and the European Community have been and still are very concerned about competition from Japan, especially in areas such as cars and electronics. There is a strong feeling that Japanese success is the result of "unfair" features of Japanese policy or of the Japanese economy. Much attention focuses on Japanese trade policy, the presumption being that the present success of the Japanese car industry is the result of past protection. Industrial policy is also seen as playing a role, with the government cooperating with industry in choosing sectors on which to "target" export efforts. Finally, there are features of the Japanese economy that are not directly related to government policy, such as the high savings rate and the work ethic.

Traditionally, governments have negotiated about each other's trade policies, exchanging "concessions" in the form of trade barrier reductions. In recent years, the United States has, under the rubric of the "Structural Impediments Initiative," sought to broaden the agenda of trade negotiations with Japan to encompass a number of aspects of the Japanese economy which are seen as contributing to its "excessive" trade surplus. While the EC has not been as active as the USA in pursuing this line of action, it has certainly shared the concerns of the USA.

There have been considerable difficulties in deciding what are appropriate issues for intergovernmental negotiation. If governments are to negotiate on tariffs and non-tariff barriers which directly affect trade flows, it is hard to argue that industrial or agricultural subsidies which have a strong impact on trade flows should not also be included in the agenda. But there are a number of dimensions to the structural impediments debate which go far beyond the realm of price distortions, however induced, and which introduce some very tricky issues into the discourse. The Japanese market may be hard for Western firms to penetrate because the Japanese language is difficult to learn. But that seems best treated as a fact of life rather than as an unfair Japanese practice requiring a compensating concession from the Japanese. If the Japanese work longer hours than Europeans, is that fair or unfair competition?

It is generally accepted that competition from low-wage countries is not unfair; for lower wages may be the only way that these countries can compensate for their relative disadvantages in technology, and/or in capital. But if it is "fair" to compete by offering lower wage rates, is it equally fair to compete by offering longer working hours, or by accepting unsafer working conditions or a higher degree of environmental pollution? If the structure of Japanese retail trade makes it harder for foreign producers to gain market access, is that a "natural" feature of the trading world, or an artificial and unfair barrier? Clearly the wider the agenda for negotiation, the greater the scope for increased friction and tension. The underlying issue is the extent to which the Japanese trade surplus is the natural consequence of a high Japanese rate of saving, or the natural consequence of Japanese efficiency in the manufacturing of products such as cars and CD players, or the "unnatural" result of unfair policies targeted on particular sectors. Whatever justification can in principle be offered for the Structural Impediments Initiative, its existence is eloquent testimony to the strains imposed on the world trading system by the asymmetries in the trilateral relationship between Europe, Japan and the United States.

### The Implications of Economic Reform in Eastern Europe for Future Trade Trends

The evolving pattern of intra-European trade will clearly be an important influence on trade relations between Europe as a whole and the rest of the world. At the same time, the path of economic change in Central and Eastern Europe is unpredictable. Therefore the effects on international trade of that process of change are equally unpredictable. But the question is so important that it is worth having a go. Preliminary answers have been offered by CEPR (1991), Collins and Rodrik (1992) and Hamilton and Winters (1993). Whether we look at historical patterns of trade, or try to infer from the trade patterns of comparable market economies, the indications are that the countries of Eastern and

Central Europe will see dramatic changes in the volume of their trade with the "West," the United States and Japan as well as Western Europe. But what structural trends will emerge as this trade expands?

The simplest observations to be made relate to natural resources. Several of the successor states to the Soviet Union are rich in energy, and should increase their energy exports if economic reform succeeds in improving the technical efficiency of the energy sector. Most of the countries in the region are well endowed with agricultural resources, though backward in agricultural performance. Agriculture, is, of course, the area in which the most dramatic responses to domestic economic liberalization may be expected. Here again, then, substantial increases in exports could, *ceteris paribus*, be expected. More subtle changes might be anticipated in the pattern of manufacturing output and exports. Comparative advantage in industrial products is much influenced by endowments in factors of production. Eastern and Central Europe are certainly short of modern capital, but there is impressive evidence that they are relatively well-endowed with well-educated labor. Hamilton and Winters unearth evidence to suggest that the Hungarian education system could be one of the best in the world. In the recent past, much of this educated labor may have been wasted in military and other socially unproductive employment, and there is undoubtedly a desperate shortage of basic commercial skills, for example, in marketing, accountancy, and banking. None the less, the labor endowments of Poland, Hungary and the Czech Republic and maybe also those of Russia, the Baltic states, Byelorussia and Ukraine, do not suggest that these are countries that will slot into the international division of labor on the same rank as Singapore and Indonesia, or even Greece and Portugal, but rather at the level of Spain, Italy and Ireland, as producers of a wide range of industrial products including some involving quite high technology, and as the hosts of substantial volumes of foreign direct investment.

The path to this happy state will not, however, be a smooth one. From the standpoint of the individual economies of Eastern and East Central Europe, it is clear from the relevant chapters of *The National Economies of Europe* that restructuring policies, with all their undoubted successes, have still not provided a reliable key to "unlock" comparative advantage. On the international side, too, there are still plenty of obstacles. The European Community has the central role of overseeing and facilitating the re-entry into the world economy of the Eastern and Central Europeans. The first major step was taken in December 1991, with the signing of association agreements between the Community on the one hand, and Poland, Hungary and (former) Czechoslovakia on the other. These agreements represented a major advance, not least because they seemed to hold out the promise of eventual membership of the Community. But, as ever, the Community is mindful of its own short-term interests as well as its historic mission: the reforming economies continue to face the threat of anti-dumping actions and pressures not to allow too rapid export growth in "sensitive" product areas, such as steel, textiles, footwear and agricultural products, notwithstanding the fact that such products may offer the best prospects to the Eastern and Central European economies in the short to medium run.

Has "1992" Made the EC More Protectionist?

The attention of the European Community, since 1992, has centered around the issue of progress towards political and monetary union. But these two developments flow from the "1992" Program, and it is from the "1992" Program that we shall learn whether the Community is to be a fortress or a member of a more open world order. Mrs. Margaret Thatcher argued in late 1991 that the more integrated the Community becomes, the less open it becomes to the rest of the world. Is this a fair judgment?

The Common Agricultural Policy lies at the root of most of the fears of the rest of the world. As we have seen, the CAP is harmful to European consumers as well as non-EC farmers, and it is not particularly beneficial for many, especially for those with small land holdings, EC farmers. In spite of its economic and budgetary costs, the CAP was proven to be remarkably resilient, and was the major obstacle to the completion of the Uruguay Round of trade negotiations. Not only does the EC start off from a point that is, at least was, unacceptable to its trading partners, but it shows little inclination to move from that point. And this is a Common Agricultural Policy, the first genuinely EC-wide economic policy. It is dangerous, however, to assume that a bad EC policy is the result of the process of European integration. Evidence from its dealings with the Third World, primarily, shows that the

Community is generous so long as its own sensitive interests are not threatened, and this sense of conditional generosity is strengthened as we move down the hierarchy of preferences to those trading partners in Asia that have been most consistently subjected to anti-dumping measures and VERs. The EC has been strongly criticized for its misuse of such measures, but again it is not clear that these policies are the result of European integration, or that they will get any worse as integration proceeds.

If we want to obtain a clear perspective on the likely impact of European integration on the world trading system, we need to look more closely at what the "1992" process really means. The essential objective is increased international competition within the EC. The emphasis on mutual recognition of standards as the principal means of removing border barriers has in itself a strongly deregulatory effect, as the least demanding national standard will tend to become the European standard. One result will obviously be to open the EC market to non-EC producers. As the German market is opened to French beer, it is opened also to American beer, because the French market is already open to American beer. When European car manufacturers are required to obtain only one set of certification to give their products access to the whole EC market, so Japanese manufacturers will enjoy the same benefit. At the same time there will be trade diversion, as barriers are reduced in a way that favors intra-EC trade against extra-EC trade. More important, as European producers face the rigors of increased intra-EC competition, they may lobby for increased barriers to extra-EC competition.

The European car market provides a useful illustration of the difficulties for the Community. Proponents of open and competitive markets will not applaud the agreement between the EC and the Japanese, but we should observe that national trade restrictions have been replaced by an EC-wide restriction whose effect is not more restrictive than the national restrictions, and which we are promised is to end in 1999, while the effect of Japanese foreign direct investment will be further to weaken the efficacy of protectionist measures. This important example suggests that it is still too early to say whether the "1992" Program is going to restrict access to EC markets for the rest of the world. The fact is that there are strong forces pulling in both directions.

#### The Future of Europe in the International Division of Labor

Europe faces an intensification of international competition from a number of different directions. Within the developed world, the United States may be a faltering rival, but Japanese competition becomes more and more formidable. The newly industrializing countries, such as Korea and Taiwan, continue to display rapid export growth, and their success has encouraged other Third World countries to follow the path of exported growth. The future role of China in the world economy is somewhat dependent on political developments; but in any event, it seems that Europe faces increasing competition in labor-intensive and medium-technology products from that part of the Third World that properly earns the title "developing." Some of the competition will come from the Mediterranean periphery, the Maghreb, Israel, Egypt and Turkey.

The kinds of international competition that Europe will face in the future pose considerable policy challenges. The pressure of competition from lower-wage developing countries, and the consequent need for Europe to move up the technological spectrum, will have effects on the distribution of income both between individuals and between regions. The income differential between the more skilled and the less skilled is likely to widen, as the less skilled are subject to stronger competitive pressure on world markets. Those regions, many of them on the European periphery, whose industrial structure is less advanced, may similarly find that international competition widens the gap between them and the more prosperous regions in the core.

Global competition is evident not only in markets for goods, but also in international flows of labor and investment. European firms may come off worst in competition with the Japanese, but those parts of the European economy that succeed in attracting investment by Japanese multinationals will likely do well. The direct competitive pressure on less skilled European workers comes not from the products of Third World workers, but from immigration, and there is a link between the two pressures. Increased protection of European goods markets against the products of the developing world may help to maintain the wage rate of less skilled European workers; but it simultaneously increases the incentive to immigrate into Europe. The development of policy toward migration is one of the major



challenges that Europe now faces, to match the challenge of policy-making on capital from outside Europe, as the notion of globalization develops ever newer layers of meaning.

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