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E U I W o r k i n g P a p e r N o . 1

THE EUROPEAN COMMUNITY AND THE
NEWLY INDUSTRIALIZED COUNTRIES^o

b y

J a c q u e s P e l k m a n s

November 1980



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The European Community and the
Newly Industrializing Countries

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SUMMARY

The paper investigates the European Community manufactures imports from and exports to sixteen Newly Industrializing Countries during the late 1970s at the one-digit sector level. In addition, a disaggregated analysis of the Community's manufactures imports concentrates on possible problem sectors, defined as those having fairly high NIC-import shares in 1975. The interpretation of the nature, speed and selectivity of this trade is based upon a dynamic view of comparative advantages and world-wide relocation of industrial production dependent on the stage of economic development. The forces at work are therefore fundamental and persistent. The appropriate policy response will have to be based upon a well-considered view about how the EC is going to adjust structurally. It is shown that the actual role of the common commercial policy of the EC increasingly threatens to hamper adjustment. The paper concludes with a proposal for a liberal, long-run trade policy vis-à-vis the Newly Industrializing Countries, reflecting an awareness of the costs of protection and of shifting commercial power.

The second half of the 1970's has brought a sudden awareness of what was hitherto recognized by only a few. A subset of the 'South', called the Newly Industrializing Countries (NICs), are successfully implementing some of the lessons in conventional development economics and comparative advantage, thereby rapidly increasing their competitive exports to the market economies of the North.

The present paper investigates the trade flows during the late 1970's between the European Community and sixteen NICs, selected primarily on the criterion of rapid growth of exports of manufactures to the Common Market. This will be done at a fairly aggregate and a disaggregated level of sector specification and considering briefly some other determinants of export increases such as direct investments of Community firms in some NICs and protectionist Community policies. After a short digression on the relation between trade policy and adjustment to imports of manufactures from NICs, the case for a liberal and well-considered common commercial policy towards the NICs is presented.

1. The NICs: who is who?

Although there is no established definition of NICs, one usually adopts the OECD (1979, p. 21) definition: less developed countries (LDCs) that show

- a fast growth in the level and share of industrial employment
- an enlargement of export market shares in manufactures
- a rapid relative reduction in the real per capita income gap separating them from most OECD countries.

This delimitation conveys the relevant characteristics, but

does not provide strict demarcations for empirical research. As Table 1 shows, NICs are defined quite differently in different studies (see first four columns). Given our concentration on the trade flows between the EC and NICs, and the related trade policy of the Community, it is especially the second OECD criterion that seems to be of primary concern. Yet, in passing, it is not unimportant to note that NICs can be found with widely divergent GNP per capita. Table 1 also shows that the structural growth rate of total exports is an unreliable indicator, ranging from 8.8% to 35.2% for 1970-1978. In comparison, it should not be ignored that most OPEC countries achieved rates between 24% - 38% and that many little noticed newcomers (often with a very small export base) registered export growth rates beyond 20%.¹

Concentrating on the composition of NIC exports, Table 1 brings out clearly that the share of manufactured goods in total exports is either very high for a non-OECD country (South Korea, Hong Kong, Israël) or rapidly increasing. Only two countries out of the 22 in the list (Venezuela, an OPEC member; Egypt) fail this test and one country is a bit sluggish in this dynamic club (Chile, but political reasons have counted heavily here).

¹Such countries and territories as Ecuador (27.4%), Trinidad & Tobago (22.6%), St. Lucia (24.2%), Bahamas (43%; the record), Cuba (23.2%), Tunisia (22.9%), Congo (27.0%), Guinea (26.9%), Rwanda (22.4%), Botswana (27.6%), Brunei (41.6%) and Macao (23.9%). The list is incomplete. All rates over 1970-1978.

Table 1

Some Indicators of possible NICs
(US dollars; percentages)

	UNCTAD	Edwards	OECD	EC	1978 GNP per cap.	Growth rate of exports: '70-'78	Share of manufactured goods in 1968 exports	Share of manufactured goods in 1977 exports
(S) Korea	x	x	x	x	1,160	35.2	73.7	85
Singapore	x	x	x	x	3,290	24.5	22.2	44
Taiwan ^c		x	x	x	1,400			49
Hong Kong	x	x	x	x	3,040	19.4	94.7	94
Mexico	x	x	x	x	1,290	16.0	18.2	29
Brazil	x	x	x	x	1,570	21.0	6.4	26
Spain		x	x	x	3,470	21.0	44.7	71
Greece			x	x	3,250	21.7	17.8	50
Yugoslavia		x	x	x	2,380	16.4	55.9	69
Turkey			x	x	1,200	13.5	3.0	25
Portugal		x		x	1,990	11.1	59.7	70
Argentina			x	x	1,910	16.7	10.3	24
Philippines	x		b	x	510	15.0	7.0	25
Malaysia	a		b	x	1,090	20.0	6.1	17
Venezuela			b	x	2,910	18.5	0.5	2
Chile			b	x	1,410	12.1	2.8	7
Israël					3,500	19.6	70.1	80
India	a		b		180	16.8	44.5	56
Columbia			b		850	17.5	9.5	19
Thailand			b		490	22.6	3	19
Egypt			b		390	11.9	26	25
Pakistan			b		230	8.8	49	57
Ireland					3,470	20.4	32.3	55
Japan					7,280	20.3	79.4	97

Notes: The headings of column (1)-(4) are: UNCTAD (1979, p.24, fn.3); Edwards (1979); OECD (1979); EC (1979, p.41, Table III-11, fn.1). Though Edwards (1979) occasionally mentions other countries, these are not related to general indicators, as his 'main' nine NICs are. They are not included above. a = At UNCTAD, 1979, p. 326, this country is added to the six NICs listed. b = possible future NICs, or substantial suppliers of manufactures, according to the OECD (1979, p.24); they are not included in the OECD study. c = Taiwan does not always feature any longer in UN official statistics. The World Bank (1980) includes Taiwan. However, note that the manufactures share of exports in 1976 is 85%, according to World Bank (1979). It seems unlikely that the huge difference is solely attributable to a change in Western protection.

Sources: UNCTAD (1979) and World Bank (1980); various Tables.

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For the purpose of the present paper, concentrating on the Community's relations with NICs, a further delimitation seems appropriate. As elaborated below, a NIC will be defined as a less developed country, the Community's manufactures' imports from which grow at least as fast as the Community's manufactures' imports from the world.

This criterion eliminates those countries that would

only be NICs for the US, Canada, or Japan but not for the EC (like Mexico), as well as countries supplying the EC at a rapidly increasing rate with products other than manufactures, and those with a poor record in export growth of manufactures in general (like Yugoslavia). Since 'manufactures' is still an aggregate of very many products of different sophistication, a moderate export performance to the EC in this aggregate may still conceal sharp increases at the product level. The delimitation procedure can therefore only be complete on the highly disaggregated level. Not only would such a complete procedure be extremely laborious, it would also be hard to distinguish incidental EC import jumps from trends. In addition, NICs tend to spread their industrialization efforts quickly beyond the few initial products and even beyond the one or two starting sectors; to detect patterns therefore one would still need a more aggregate approach.

The above requirement eliminates from the set in Table 1 the following countries, with EC bilateral import growth rates of manufactures below that of the EC import growth rate of manufactures from the world (107.2% for 1975-1979): Yugoslavia (86.6%), Mexico (68.1%), Colombia (5.5%), Pakistan (95%) and Chile (86.5%).

It leaves the following sixteen² NICs for the present study: South Korea, Singapore, Philippines, Malaysia, Thailand, Hong Kong, Taiwan, India, Turkey, Greece, Portugal, Spain, Brazil, Argentina, Israël and Egypt.

About half of these countries have special trade relationships with the EC. Greece has become a member of the Community as of Jan. 1, 1981, although its market access will only gradually improve. In a few years, however, its status may be expected to be comparable to another dynamic exporter within the Common Market: Ireland. It is quite obvious that by the middle of the 1980's trade policy measures against Greece will become practically impossible. Spain and Portugal have applied for membership. At present Spain has marginally and Portugal considerably better access than non-Lomé LDCs (as an EFTA member it has free access for most industrial products since 1977, and faced lower tariffs before). Relations with Turkey are theoretically similar to those with Israël but various political sensitivities have caused serious problems in the past (and again in Sept. 1980). Israël enjoys free-trade-area status for industrial goods since 1977. Philippines, Singapore, Thailand and Malaysia are members of ASEAN, which has concluded a trade treaty with the EC in 1979. Its influence on the analysis of the recent past is negligible,

²Venezuela falls out as well as it is an OPEC member. In the near future ignoring it might be incorrect. From 1975-1979 EC manufactures' imports from Venezuela soared from 4 million (EUR) to 77 million ECU. This absolute value is however still insignificant on the big Common Market. (For EUR and ECU, see below, Table 2.)

but future trade policy will have to reckon with this fact.

None of the sixteen NICs considered here are parties to the Lomé Convention, but South Korea, Hong Kong, India, Brazil, Argentina and Egypt benefited from the Community's Generalized System of Preferences, as valid until 1980. Of course, most of the other countries mentioned have this possibility as well. Taiwan, finally, has no official diplomatic status with the European Community any more. Although there are informal contacts it is hardly a speculation to suggest that this leaves Taiwan in an extremely unfavourable position, only mitigated by a relatively large stock of EC direct investments on its territory.

2. The NICs as a trade policy issue

If we ignore problems of autocratic domestic politics and of suppressed trade unionism, deplorable phenomena in several NICs (but of course common to a series of other less-developed countries), the NICs are a success story. They represent a dream of conventional development economics come true. Therefore, it is not immediately clear what the Community's policy problem could be the NICs would pose.

Fast rising GNP per capita and a rapidly increasing working population in manufacturing are typically achievements to be satisfied with. Only the idea that NICs increase their export market shares in manufactures could be worrisome, but it need not be as rapid industrialization creates export markets for the European Community's machinery and technology exporters and induces a general rise of import demand over a large range of products. The mere fact, first brought out by the OECD (1979, p. 8) that import penetration³ of ten NICs in-

³ Import penetration is defined as imports (here, from NICs) as a

to the OECD market of manufactured goods in 1977 had barely passed 1% seems to destroy any case for considering the NICs as a threat.

The question is indeed a more subtle one.

The policy problem for the European Community consists in the nature and speed of adjustment to rising NIC shares in a limited number of product markets, both within the Common Market and outside. These problems of adjustment come on top of the strains caused by a less favourable growth climate and by uncertainties about energy prices, inflation and the return to business investment. A major issue of this paper is the role of the Community's common commercial policy in the adjustment to rapidly rising imports from NICs. It will lead us to the question whether an economically and diplomatically superior policy would not be possible.

Whether LDCs are switching from import-substituting to export-oriented industrialization strategies, or development plans are concentrating resources on key products, rather than spreading them out over a host of suboptimally sized plants in many

percentage of apparent domestic consumption. Apparent consumption is (domestic) production plus imports, minus exports. Import penetration has to be distinguished from import share: imports, of a certain product or from a certain country, as a percentage of total imports. The two yardsticks may give very different pictures! See also section 3.

sectors, initial NIC export strategies tend to be highly specific. Producing large volumes of a very limited range of goods, in which they know they can achieve great cost advantages, they select one big or a few medium-sized OECD economies as export markets. Such precisely targeted export drives in standardized goods may derive from a lack of broad marketing knowledge but they sometimes seem to be carefully planned within multinational production corporations investing in NICs for the sole purpose of assembly or by world-wide trading companies, distribution chains and international department stores.

In addition, more advanced NICs moving into products with a larger physical capital content may be aided by the local government or, again, by multinational producers to set up large-scale industrial complexes in steel, automobiles or textiles. Once production is on stream, exports may rise extremely rapidly.

The adjustment problem being product specific and, at that level, one related to sudden jumps in import growth rates, the question is almost by definition of negligible importance on any aggregate level of economic analysis or political economy. This creates a grave danger for undetected piecemeal protectionism, thought out between specialized bureaucrats and threatened producer lobbies. In the European Community the danger is even greater as external commercial policy is almost completely in the hands of Eurocrats, talking directly with pressure groups, and invisibly supported, or blackmailed, by national bureaucrats in the Committee 113, without a serious parliamentary control, and without publicly accessible procedures or hearings. 'Solving' adjustment by piecemeal trade policy making on a high level of disaggregation does not arouse a great deal of public interest for perhaps quite

a while. A continuous monitoring of it is tiring and boring and hardly makes small headlines even in the best informed newspapers.

Detecting the NICs, in so far as they pose a trade policy problem is therefore not quite the same as defining a NIC with respect to the aforementioned criteria. On the six-digit product specification level, a less developed country may be seen to have rapidly increasing exports to the EC, or to one or two member countries only, whereas that country's export performance on, say, the two-digit sector level need not show up as above-average. It might also fail to classify as a NIC on the basis of rising GNP per capita or on the basis of an increasing share of employment in manufacturing. It follows that, whilst the definition of a NIC takes place at the aggregate level, very similar problems may also be caused--on the disaggregated level--by generally unsuccessful, poor countries with a single product line that manages to penetrate the EC. The point is that the NIC problem for the EC (and the OECD in general) is inevitably part of the overall adjustment to shifting comparative advantages in standardized products to all less developed economies.

More precisely, it has to be placed in the framework of dynamic comparative advantage to acquire an insight in the fundamental and persistent forces at work. Though the economics of these processes are exceedingly complex, its broad nature is well-understood and has been given empirical content (Balassa, 1979).

The idea is that economic development in a fairly open world economy tends to follow a stages approach with respect to factor input and types of products competitively produced for the world

market. On the factor input side, availability of a minimal physical, social and educational infrastructure is required. This has proved to be easier in development plans than in actual practice, especially with respect to the latter two. Without these infrastructural provisions it is difficult to expect that product and factor markets can work in a poor country. Moreover, it seems even more difficult to achieve stability of supply and expect sufficient productivity--even with the lowest wages--to result in cost advantages over established world producers. Typically, today's NICs tend to have either a high literacy rate or an ample supply of literate, but low-skilled workers (the latter applies to India and Egypt, for instance).

The types of products at the lower stages of development and comparative advantage can be associated with small scale manufactures' production. like clothing of simple varieties. simple non-fashion footwear and handbags, simple toys and souvenirs and certain simple processed primary commodities, statistically counted as manufactures, such as certain wood manufactured products. The emphasis on 'simple' and 'small scale' has to do with the presumed shortage of physical capital, needed for large-scale production and the presumed shortage of entrepreneurial, organizational, design and marketing capacity in countries that begin to industrialize.

They may advance by gradually building up experience, purchasing technology, or machine-embodied technology so as to diversify into more demanding products. The entry into higher stages may be accelerated by foreign direct investment bringing in excessively scarce factors. These investors may re-organize or create production but they may also facilitate direct entry into markets of advanced countries by subcontracting or production for retail chains.

The other, not mutually exclusive, route is stringent planning of industrialization by concentrating resources on a few key products that are sufficiently standardized to expect export success, yet sufficiently advanced to move beyond the beginnings of efficient manufacturing. The 'rifle-shot' approach⁴ makes sense in avoiding sub-optimal plant size but obviously risks a collision course in willingly pursuing the disruption of advanced country markets if it is done too aggressively. However, 'rifle-shot' incidents seem to be typical of young NICs with insufficient diversification.

Further stages would push the now semi-developed country into less standardized products, or physical capital intensive goods with simple production processes while perhaps still improving on its productivity in the low-skill intensive, standardized goods in order to continue competing with emerging young NICs. Eventually the NIC 'graduates' into something like a newly advanced country (a NAC?) with a broad industrial base, possibly seeing its initial success sectors decline into comparative disadvantage sectors and still aiming for the production of certain specialized high technologies.

Of course, one should not exaggerate the model-like smoothness of this complex process. One should also beware of the fiction that industrializing LDCs are all strongly export-oriented. Many of them are not. Some are basing their development strategy on exports in a few key sectors only. It is a minority that is

⁴The expression is in Turner et al. (1980, p. 20). The celebrated example is about three South Korean plants producing TV sets for the US market (only!) and achieving an output of some 400,000 units a year each. US protection forced them down to half. Here, scale economies do cause market disruption.

truly export-oriented. The trade policy issue is of course not that poor countries are industrializing but that a small but growing number of them pursue the objectives of productive efficiency, growth, urban employment and maximizing foreign exchange earnings by relying on exports of manufactures.

The economic case for singling out NICs as a subset is then that the combination of product specificity and extreme import growth rates can cause severe problems for a limited group of firms and traders that might push up the cost of immediate adjustment beyond the society's gains from trade.

The institutional case for singling them out is that GATT, art. 19, dealing with 'market disruption', is often avoided and obscure, bilateral, sometimes even unpublished trade policy instruments are applied as substitutes. It is the NICs that suffer most from these 'lawless' commercial policy dealings, only too often ruled by power and too rarely by considerations of industrial adjustment. As demonstrated by the Community's feverish attempts to obtain agreement on a 'selective safeguard clause' in the Tokyo Round, the NIC issue has now assumed great institutional significance.

3. Recent EC-NIC trade in manufactures

Within the European Community and beyond, protection against present NICs, and old ones like Japan has often been defended in trade policy circles by pointing to extreme import growth rates as well as to 'intolerable' bilateral trade defi-

cits. The first phenomenon is suggested to indicate market disruption and the second one an inappropriate 'burden' of adjustment. As both indicators will be used in this section, some further discussion seems desirable before examination of the evidence.

In the first place, import growth rates may be considered as a signal that possibilities of 'market disruption' might arise, especially in times of recession. However, a proper investigation would have to be conducted at a high level of disaggregation. Moreover, the case should be made that 'serious injury' is attributable to the imports and not to technological change, factor substitution (i.e. replacing men by machines) or a fall in demand. Usually, though, it is one or more of the latter factors which cause a fall in the 'injured' subsector's employment. If so, and production capacity does not fall with employment, firms may be confronted with decreasing market shares due to (NIC-) competition. Such developments create strong pressures for protection because labour union and management can jointly lobby, the former primarily to protect jobs in that sector and the latter primarily to protect market shares and profits. Of course, lobbyists must present their particular case as one in which adjustment is impossible in such a short time span and undesirable given the sectoral unemployment. Import growth rates conspicuously higher than domestic production help to make the case for protection politically digestible, especially if it is directed at the 'culprits' only.

In the second place, bilateral, sectoral trade balances over time may be considered as a signal of declining competitiveness in the product group concerned. But there is nothing wrong with

declining sectoral competitiveness vis-à-vis certain countries, here NICs, as long as competitiveness improves in other product-groups. Economic growth in open economies such as the EC is precisely a result of continuous shifts to sectors of higher productivity either by further specialization within a sector or by intersectoral reallocation of productive resources. Furthermore, concern with bilateral trade flows in a multilateral trading (and payments) system is alien to its nature. Disaggregating them further into product categories, even if only of the one-digit variety, makes worries about balanced flows even less warranted. This holds especially in a North-South context where there seems to be ample scope for inter-industry specialization (rather than intra-) necessarily creating disaggregated 'imbalances' in trade flows. Such 'imbalances' are precisely the result of the deepening world division of labour. Finally, one might fear overall trade imbalances for the EC because of a loss of competitiveness. The implicit assumption is then that exchange rates do not change. If exchange rates could adjust, however, there will always be comparative advantages that can be exploited. The conclusion is that sectoral, bilateral trade imbalances over time can be utilized as indicators for competitiveness. If such imbalances enter as arguments into commercial diplomacy, and if access to both markets is roughly comparable, there is no economic justification. One suspects that the political motivation could derive from the desire to 'do something' about NIC competition or from a neo-mercantilist preference to maintain certain industries, without immediately slapping tariffs or 'voluntary' export restraints on their supplies. The imbalance argument has been a

typical prelude to further protection in the case of an experienced ex-NIC, Japan.⁵

⁵One might have doubts whether EC access to the Japanese market is indeed comparable to Japanese access to the EC. Surely, there is evidence that hidden barriers - be they hidden in the distribution system, or, in the allocation of television time, or otherwise - tend to suppress the inflow of EC products into Japan. But there is also evidence that EC firms deliberately avoid the problems of unacquaintedness with the Japanese market by opting for third markets. Furthermore, EC members have a poor record of providing Japan with market access. Some Community members already maintain several quotas against Japan for nearly three decades.

Most NICs are so protectionistic that market access is plainly not comparable with the access of NICs to the EC. The more developed they are the less appropriate this is. In brief, if a NIC 'graduates' in terms of value and composition of trade, it should also graduate with respect to the basic principles of GATT, rather than remaining exempted on the basis of a status it is overcoming (to wit: being poor).

Pleas for protection tend to rely on other economic objectives (sectoral employment, preferably at the going wage rate) or political objectives (votes; minimum sector size for 'security') than real income growth. A further essential point is that protection imposes costs on the domestic consumer and the foreign (NIC) firms, especially on workers, that only rarely enter the calculation of decision-makers. Would policy-makers in advanced countries explicitly underwrite their implicit argument that a worker in a poor NIC, thrown into unemployment because of protection in export markets, can 'adjust' with less injury than a worker in a welfare state, thrown into unemployment because of NIC competition?

Table 2 provides data about the recent developments in the Community's trade in manufactures with the sixteen NICs selected. The information is presented in such a way that some major trade policy indicators (economically justifiable or not) can be deduced from it. Essential to the NIC phenomenon are import growth rates. of course. However, such growth rates have to be used with at least some information on the import value in the base-year (1975). Whenever the import base in 1975 is low or very low, thereby enabling magnified growth rates that need not be alarming at all, this has been indicated. Policy-makers also frequently use the bilateral trade balance as an indicator. Though its use as an indicator is often suspect, it has nevertheless been provided as well. Finally, bilateral EC export growth

Table 2

EC - NIC trade in manufactures : 1975-1979
(growth rates in percentages; millions of ECU¹)

Imports from Exports to	SITC ⁴ 5-8 (%)		SITC ⁴ 5 (%)		SITC ⁴ 7 (%)		SITC ⁴ 6;8 (%)		Net EC exports ² of manufactures (1979; in ECU)
	imports	exports	imports	exports	imports	exports	imports	exports	
World	107	84	120	103	108	74	105	88	65.563
All NICs	166	70	118 ^a	87	236	62	153	74 ^a	8.885
South Korea	210	171	51 ^b	190 ^a	459 ^a	149	190	292 ^a	-415
Singapore	156	108	186 ^b	153 ^a	178	98	132	110	480
Hong Kong	125	188	58 ^b	173 ^a	196	181	117	198 ^a	-1,161
Taiwan	175 ^a	101	215 ^b	177 ^a	315 ^a	75	144 ^a	103 ^a	-748
Thailand	377 ^a	119	378 ^a	184 ^a	348 ^b	102	378 ^a	99 ^a	298
Malaysia	182 ^a	94	66 ³	140 ^a	279 ^a	88	161	85 ^a	282
Philippines	697 ^a	97	negl. ^a	119 ^a	1,028 ^b	85	663 ^a	128 ^a	286 ^c
India	146	116	119 ^a	56	110 ^a	68	149	243	549
Israel	164 ^a	39	106 ^b	106	178 ^a	33	180 ^a	31	846 ^c
Egypt	710 ^a	95	110 ^b	33	2,410 ^b	148	650 ^a	62	1,740 ^c
Turkey	133	-16	58 ^a	27	143 ^b	-22	138	-33	978 ^c
Greece	141	87	-12	92	41 ^a	60	161	139	1,913 ^c
Spain	188	60	195 ^a	86	257	51	148	58	452
Portugal	110	96	103 ^a	129	87	103	117	69	751 ^c
Brasil	169 ^a	6	77 ^a	52	329 ^a	3	143 ^a	-16	1,355 ^c
Argentina	234 ^a	117	93 ^a	82	174 ^a	160	354 ^a	73	1,279 ^c

Notes : 1) For 1975, read EUR for ECU. In 1975 1 EUR = (approx.) § 1.24; in 1979, 1 ECU = § 1.37 (average used by Eurostat)

2) Net exports = exports minus imports. A negative sign indicates a (bilateral) deficit for the EC (in manufactured goods only)

3) negl. = negligible absolute import volume throughout the period

4) SITC 5 = chemicals; SITC 7 = machinery and transport equipment; SITC 6;8 = Other manufactured goods

a) 1975 im/export base below EUR 100 million (low base)

b) 1975 im/export base below EUR 10 million (exceedingly low base)

c) EC bilateral surplus is larger than the EC imports from that country (in manufactures)

Source: Calculated from : Eurostat, Monthly External Trade Bulletin, various supplements.

rates are given.

The picture that arises is clear. The Community is increasing its imports of manufactures from the NICs at a speed two-thirds higher than the rate of growth of manufactures imports from the world as a whole. At the same time its export performance in the same goods to NICs is markedly inferior to the overall growth of manufactures exported to the world. However, the 1979 surplus with the NICs in these goods is quite comfortable by any standard: close to 9 billion ECU, which is 48% of the Community's entire imports of manufactures from the NICs! But the sharply diverging growth rates of exports and imports, if continuing, are bound to undermine this comfort rapidly. The second half of the 1970's surely points to a worrying trend: not only did the absolute EC surplus in manufactures' trade with the NICs decline from 9174 million EUR to 8885 million ECU,⁶ but the 1975 surplus was 32% larger than all EC imports of manufactures from NICs whilst the 1979 surplus amounted to a mere 48% of those EC imports.

Disaggregation into three one-digit categories shows that the true NIC problem should not be looked for in chemicals (SITC 5; SITC refers to Standard International Trade Classification). Not only are EC chemicals imports from all NICs growing a bit more slowly than EC chemicals imports from the world, the country pattern is extremely uneven and the 1975 base is very often low or extremely low. Moreover, the share of chemicals in total EC NIC-manufactures imports declined from an already small 5.3% in 1975 to 4.4% in 1979. Chemicals will therefore be ignored be-

⁶ See footnote 1, Table 2 for EUR and ECU.

low⁷ as a comparative disadvantage good for NICs.

For machinery and transport equipment the rate of import growth is very high (236%), enlarging its share in EC NIC-manufactures imports from 18% in 1975 to 23% in 1979. For a number of NICs, their base value of exports to the EC is low or extremely low, so that the sometimes fantastic EC bilateral import growth rates will still mean very little in terms of adjustment. This is reflected in the EC surplus in these goods: the huge difference in import and export growth rates has brought the surplus down from six times the absolute imports from NICs in 1975 to a little over twice the absolute imports from NICs in 1979, still very large though. The absolute surplus even increased from 7324 million EUR to 9659 million ECU. Furthermore, in 1979 no less than 46% of EC NIC-imports of machinery and transport equipment originated from Spain alone. The fact that these large imports have been growing some 257% over 1975-1979 seems to have been much more important than sensational growth rates of initially negligible imports from many other NICs.

It is often thought that machinery and transport equipment represents a category of goods strongly competitive vis-à-vis LDCs, even NICs. It appears, however, that the European Community's surplus in machinery and transport equipment vis-à-vis the

⁷Note that Southeast Asian NICs have recently increased their chemicals imports from the EC at conspicuously high rates. This might have to do with the synthetic fibre industry in these NICs. It should also be of interest to know that the 1979 EC surplus in chemicals trade with NICs is more than five times (!) the absolute value of imports from NICs.

NICs during the second half of the 1970's conceals a decline of comparative advantage. Even if 'comparative advantage' is a meaningful concept at such a high level of aggregation--I would submit that it is not--one has to qualify such a sweeping conclusion by looking more closely at Table 2. Of the 16 NICs only three show both a non-small export base in these goods and a high export growth: Spain, Hong Kong and Singapore. These three countries have a GNP per capita of more than \$3000 (1978)⁸ and may not be fully comparable with most other NICs with respect to the requirements for exports in these semi-advanced products, but rather with Ireland, or perhaps even Italy. They seem to confirm the notion that NICs pose different competitive challenges at different layers of development, both because of product-wise and sectoral diversification on the output side and because of improved endowment of human, physical and technological capital on the input side. Unfortunately, the data in Table 2 are too aggregated to enable a proper judgment on this matter, since SITC 7 lumps together goods with very different input requirements and imports of widely diverging degrees of standardization.

Most of the concerns on the NIC exports to the EC stem, however, from imports of 'other manufactured goods' (such as textiles, steel semi-manufactures, furniture, clothing, footwear, etc.). Even at this aggregate level there are a series of indications for the competitiveness of the NICs. All 16 NICs individually show higher exports growth rates (to the EC) than the world does; the four NICs that had a 1975 export base of below 100 mil-

⁸ Portugal has a low export growth (to EC) of these goods, but a considerable export base. Its GNP per capita is also much lower.

lion EUR have very high growth rates indeed (354% - 663%); the five biggest EC suppliers of these goods among the NICs increased their exports to the Community by 139% despite the dampening effect of (increasing) protection, often especially applying to their shipments; the small deficit of the Community with the NICs in these goods in 1975 had increased tenfold by 1979 and had risen to 39% of EC imports from the NICs. But even here disaggregation seems warranted before jumping to conclusions. If the EC is believed to be uncompetitive in these goods, how can one understand the fairly strong Community export performance to several East Asian NICs and to India in these goods?

A different picture of the Community's NIC manufactures imports is presented in Table 3, where the growth in NIC shares in EC imports of manufactures has been provided for the Nine as a whole and for 7 of its 8 economies.⁹

In machinery and transport equipment all NIC shares in EC imports increase but none of them had even reached the 7% level in 1979. In other manufactured goods a similar growth picture arises¹⁰ although the NIC shares are much higher.

This begs the question how arbitrary it is to use a threshold NIC share of EC imports beyond which NIC competition can be considered to become 'important' or 'sensitive'. First of all,

⁹ Ireland is left out. As discussed before, chemicals will not be considered since there seems to be hardly any adjustment problem. For a comparison with Table 3, note that the NIC share in EC chemicals imports was 2.2% both in 1975 and in 1979.

¹⁰ Except for Denmark.

NIC shares may rise due to competition among non-EC suppliers without necessarily increasing market shares. In the period considered this is not the case.

Table 3

NIC shares in manufactures¹ imports of the European Community
(1975-1979; percentages)

	SITC 7		SITC 6/8	
	1975	1979	1975	1979
EC ² of 9	2.70	4.36	8.60	10.71
Germany	4.0	4.9	11.1	13.1
France	3.9	6.4	7.3	9.7
Italy	1.7	6.3	7.0	11.2
Netherlands	1.9	2.9	5.0	7.6
Belgium/Lux.	0.9	1.0	4.6	6.7
Great Britain	2.7	4.3	12.7	13.1
Denmark	1.0	1.6	5.9	2.3

Notes: ¹ Only SITC 7 (machinery and transport equipment) and SITC 6/8 ('other manufactured goods'); not chemicals (SITC 5).

² EC includes Ireland; Ireland is not listed separately.

Source: Calculated from source, Table 2.

Not only the NIC share of extra-EC imports has risen over the period both for machinery and transport equipment (from 8.1% to 12.6%) and other manufactured goods (from 21.0% to 25.0%), but

the ratios of extra- over intra-EC imports have moved up as well (resp. from 0.50 to 0.53, and from 0.69 to 0.74). In the second place, a rising import share accompanied with rising home production for exports, say in quality goods, need not inflict any pressure on domestic producers, facilitates the shift to higher value-added output and is beneficial for consumers. Therefore, what one really wants to know are 'market shares' (or the rate of import penetration) rather than 'import shares'. The import penetration rate, defined as imports (from NICs) as a percentage of apparent domestic consumption (domestic production minus exports plus all imports), is very hard to come by for statistical reasons.¹¹ This is unfortunate since a rising penetration rate necessarily means more competition and a lower market share in the domestic market. The loss of strength in the domestic market is a fate every producer would like to avoid, no matter how strong his exports are. Furthermore, competitive pressures of NICs are easily relayed to third markets which would spell contraction abroad. However, the condition for using penetration rates and even more for import shares, to indicate the 'sensitivity' to NIC imports is that the level of disaggregation is high so as to be reasonably sure about the homogeneity of the products. But even at the three-digit product specification of many products this homogeneity condition is not easily fulfilled. A striking illustration of the point is in SITC 831 (travel goods, handbags, etc.) where Italy joins other EC members in having high NIC

¹¹ The most important reason is that trade and industry statistics are insufficiently harmonized as to their nomenclatures. Penetration rates, if published at all, are usually several years behind, and rather aggregate.

shares of these imports while persisting its export drive unabatedly, in contrast to all other EC members where exports have vanished. The explanation is that further disaggregation would show Italy's great comparative advantage in the luxurious 'up-market' products within this category. Using import shares is therefore second best to penetration rates, if available at all. The method is not fully reliable as an indicator of 'sensitivity' to NIC competition.

It follows that Table 3 should be used with caution. Perhaps the most interesting aspect is the change in import shares. In machinery and transport equipment Spanish auto exports to France and Italy seem to be a major cause for a rapid increase of the NIC share, while in other manufactured goods the same phenomenon is more muted. Another interesting feature is the moderate increase in the NIC share of British imports of 'other manufactured goods'. One wonders whether Britain has been allowed to be more protectionist, either informally or within the common commercial policy.

4. A disaggregated analysis of selected sectors

The previous section provides a useful perspective but the core of the NIC problem can only be studied by disaggregating further (Hager, 1980). On the other hand, it seems impossible to extract a coherent picture from the multitudinous nitty-gritty issues of daily trade policy on the product level.

A reasonable compromise will be adopted in taking a considerably higher level of disaggregation than in the previous section without risking to lose oversight by studying many thousands of single products. This can be done at the intermediate level

of SITC specification. The example of textiles (not clothing) may illustrate what is involved. Textiles are first specified as a sector at the two-digit level (as 65): the NIC share in total EC imports of textiles was 9.3% in 1975. At the disaggregated level one may observe a NIC share of 1.5% in EC imports of 'yarn of continuous synthetic fibres, etc.' (SITC 65161), next to a NIC share of 58% in 'cotton yarn & thread, grey, not mercerized' (SITC 6513) and one of 27.9% when the same cotton yarn & thread is mercerized, bleached or dyed (SITC 6514). Yet, the EC total of the latter two imports together, though on the four-digit level, is only half the value of the EC total of the imports of the former, despite its classification at the five-digit level.¹² Except for specific sectoral studies, it seems more useful to move beyond the casuistry of literally thousands of product types with very different import weight and attempt to grasp the nature and extent of the problem of varying levels of intermediate aggregation. Even with such an approach the degree of detail already hampers the consistent reference to the underlying process of world-wide structural economic change.¹³ It also has to be realized that the choice of 'machinery and transport equipment' plus 'other manufactured goods' makes the analysis even more selective.

One drawback of this method ought to be kept in mind as it occasionally may play a role: at the intermediate levels of disaggregation, products are classified with respect to end-uses but these need not imply similar input requirements. In the framework

¹²The SITC used here is the first revision. A second revision has caused further changes, but does not touch upon the nature of the argument of course.

¹³In addition, high degrees of disaggregation can only be used se-

of dynamic comparative advantage information on both is required. In terms of our textile example, 'yarn of continuous synthetic fibre' (SITC 65161) is essentially a chemical product from a physical capital intensive industry and often based on oil derivatives, whereas 'cotton yarn & thread, grey, not mercerized' (SITC 6513) can in principle be produced on simple spinning machines with substantial low-skill labour, raw cotton and small-scale plants. The great difference in NIC shares of EC imports of the two textiles can be readily explained in terms of availability of factor inputs if one disaggregates fully, whereas some of these insights are lost when imports are studied at the level of 'textile yarn & thread' (SITC 651).

Table 4 provides summary information by means of various indicators on the NIC performance in EC manufactures' imports (except chemicals) in a number of selected three-digit sectors, with some two- or four-digit ones if relevant. Sectors have been included if, in 1975, the NIC share of EC imports of the category concerned was above 10%. If this was the case already at the two-digit level, higher degrees of disaggregation have been avoided. In other words, the highest degree of aggregation has been chosen at which the 1975 NIC share in sectoral EC imports was above 10%. It is expected that, with the possible exception of a single product case outside these sectors, a fairly broad, yet disaggregated picture of NIC-EC manufactures trade, and particularly its sensitive elements, can be so provided. However,

lectively as one runs into very serious data problems. The OECD, for instance, is not consistent over the years in presenting the (same) five-digit product groups or in presenting a country breakdown for them.

Table 4

Some characteristics of EC¹ imports from NICs; selected sectors
(1975-1979; percentages; millions US-\$)

Sector	SITC ²		EC 1979 imports from NICs \$	Share in imports		Import growth rate 1975 - 1979 (%)	NIC share in EC imports of sector	
	old	new		SITC 6/8	SITC 7		1975	1979
1. veneers, plywood	631	634	538	4.0		261	14.6	21.8
2. textile yarn & thread	651	651	1,015	7.6		171	12.9	17.0
3. woven cotton fabrics	652	652	552	4.1		145	15.2	15.8
4. made-up text. art.s	656	658	420	3.1		151	26.8	30.0
5. cutlery	696	696	90	0.7		95	18.0	19.8
6. metal household art.s	697	697	248	1.8		185	17.1	18.3
7. calculating & acc.mach.	7,142	7,512	113		2.7	0	19.3	17.6
8. t.v. receivers	7,241	761	248		5.8	177	7.5	14.5
9. radio receivers	7,242	762	594		14.0	179	21.9	35.3
10. travel goods, handbags	83	83	372	2.8		335	22.9	36.8
11. clothing	84	84	5,291	39.4		141	27.3	30.5
12. footwear	85	85	894	6.7		205	16.0	19.6
13. toys, games, sport goods	894	894	589	4.4		192	18.2	21.3
(Total)				74.6	22.5			

Notes : 1) EC does not include Ireland

2) The sources of the data base (see below) have switched to the SITC, second revision, during the studied period

3) Only SITC 6/8 and SITC 7; not chemicals (SITC 5)

Sources: OECD, Trade by commodities, market summaries, imports (2 Vol.s), Series C, 1975;
OECD, Microtables import/export 1979, by country. Calculations by the author

one should appreciate the selectivity of the presentation in its concentration on possible problem sectors. In addition, two exceptions to the above-10% criterion have been made in cases where evidently no adjustment issue has arisen in the European Community.¹⁴

Eleven out of thirteen sectors show an enlargement of the NIC share in EC imports of more than one percentage point, with radio receivers and travel goods, handbags, etc. making a spectacular jump of some 14 points in four years only. Calculating and accounting machines is the only sector where the NIC share declined (by 1.7 points) but even here one has to be careful about the volume as the simple calculators declined in price (at least relatively to the more sophisticated ones). NIC exports in this sector are heavily concentrated in simple calculators the production of which has now become fully standardized.

The general NIC performance in what presumably could be 'problem sectors' is remarkable. As we shall see later, in a number of these sectors NICs suffer from protection, often quan-

¹⁴In 'wood manufactures, not elsewhere specified' (SITC 632; boxes, cases, crates, builders' woodwork, etc.) there seems to be little if any such problem. This has to do partly with the preponderance of the raw material input and partly with the already achieved specialization in quality wood in many EC countries. Beyond any doubt is the case of cork manufactures (SITC 633) where Portugal and Spain together reach a share of 83.4% of EC imports in 1975 and a Community industry hardly exists. Furthermore, TV receivers is a special case (see text).

titative protection. Table 4 strongly suggests that such protection has served as a brake at best.

Four sectors have moved from NIC shares in EC imports of above 20% to shares above or equal to 30%. This seems to be rather high and may be expected to lead to adjustment problems if import value or speed (or both) are considerable. The 1979 import values (from NICs) are surely not small (\$372 million or beyond) with clothing as a very large one. The rates of import growth are much higher than one might expect by comparison to non-problem sectors or overall rates. For example, all four are considerably higher than the overall EC import growth rate for SITC 6/8 (105%; see Table 2) or than for chemicals (120%). Another interesting comparison is with the 6% growth norm of the first Multi-Fibre Arrangement (1973-1977): if these high NIC share sectors would have been subject to an across-the-board rule of 6% EC import growth from NICs, and if EC inflation in the period is assumed to have been 10% annually,¹⁵ the import growth rate for NICs would have been 81%. The four growth rates, however, are close to or beyond twice such magnitudes.

If one pays attention to import growth rates--a crucial indicator for NICs compared with other LDCs--the performance is impressive, given increasing protection and a low growth climate in the Community. Assuming an EC inflation of 10% annually, the real average import growth for eleven out of thirteen sectors has been

¹⁵This is higher than the actual weighted average. The consumer price deflator and the import price deflator for the EC are resp.: 1976 (10.1 and 11.5%); 1977 (9.7 and 8.3%); 1978 (7.1 and 0.5%) and 1979 (9 and 10%). European Economy, March 1980, p. 129.

above 14% annually (from NICs) and even reaches to slightly beyond 25% (travel goods, handbags, etc.). Though Table 4 gives a very partial view of the Community's imports, it does show that the NIC performance has now spread over a considerable number of sectors combining fairly high import shares for these countries with high growth rates of their supplies.

On the other hand, the competitive pressures from NICs are still heavily concentrated in these thirteen sectors. The ten sectors resorting under 'other manufactured goods' make up no less than 74.6% of the total EC NIC-imports in these goods in 1979, whereas the three sectors listed, resorting under 'machinery and transport equipment', only reach 22.5% of total EC NIC-imports of these goods (which are already modest, see Table 3). Apart from radio and TV sets and perhaps some electrical appliances, SITC 7 does not encompass adjustment problems vis-à-vis the NICs. Even in the products mentioned, it is Japan which causes pressures, when they arise at all. This holds especially for TV sets and not so much for radios although the latter's EC import growth rate is much more impressive and starts from a larger base. The big electric/electronic companies of the Community seem convinced that radios are a market without any growth potential and an evident comparative disadvantage (only France has had temporary protection). The colour TV set market is not yet saturated, however, commits much more resources than radio production (per set) and pertains to some significant technological issues. The most important one is patent protection for PAL colour technology which, it is feared, cannot compete with Japanese technology once the patents expire (1981). The significance of the NICs is merely that they further add to these pressures. In mid-1980 one could observe Philips (Dutch) and Thomson (French) trying to organize a strong case for

EC trade protection against colour TV sets to replace the shelter provided by the patents.

Another example in SITC 7 can clarify why the NICs only exceptionally cause sectoral adjustment problems there. The dominant share of Spain in the NIC share of imports of 'machinery and transport equipment' is not due to the sectors mentioned in Table 4 but to such sectors as 'office machines other than calculating and accounting machines', certain 'non-electrical machinery and parts', 'internal combustion engines' and, above all, automobiles, primarily exported to France and Italy. In all these internationalized sectors, the NIC (or Spanish) share is very small for the Community--except for French auto imports from Spain. Moreover, trade often results from direct investments of Community firms so that the adjustment is taken care of by the market. However, the small NIC share in total SITC-7 EC imports of these goods still represents a large part of the EC imports of 'machinery and transport equipment' from NICs.

The 'machinery' sector seems to be one of the few sectors where EC direct investments in NICs generate substantial imports of goods previously produced in the Common Market.¹⁶ Trade creating direct investments tend to accelerate the exploitation of the potential comparative advantages of NICs. A dramatic instance can be detected in the case of thermionic valves, etc. (SITC, old, 7293; new, 776) where the 1975 NIC share in EC imports is only 6.2%. But this does not include Dutch non-allocated imports--pre-

¹⁶See Turner et al. (1980, p. 8) where the importance of direct investments is argued to be minor. For a survey, see Nayyar (1978).

sumably from Philips's subsidiaries¹⁷ in Taiwan and Singapore-- , bringing the NIC share to 19.0%! In 1979, the NIC share has grown to 23%, including 11.0% or close to half a billion US dollars for Philips alone. It is typical that the extremely internationalized electronics sector plays the game of protection (Philips on colour TV sets) together with the exploitation of comparative advantage of NICs in specific other goods (Philips in the Far East) and research-intensive breakthroughs in advanced technology (Philips on video/disc innovations).

The story is quite different in 'other manufactured goods'. The nature and extent of the adjustment problem is not merely determined by the combination of initially high import shares of NICs (often higher than in SITC 7) with high growth rates of NIC imports, but also by the fact that further specialization into high value-added 'up-market' products has become increasingly difficult because entire sectors have lost their comparative advantage. As is known, the adjustment pains of dismantling and dismissals so as to move to another sector (intersectoral adjustment) are usually considered to be much greater. For workers of any skill-level except the minimum, it may imply that their sector-specific knowledge and experience depreciates sharply in value, in turn causing personal problems of acceptance and lower wages elsewhere. Even more serious is the possibility that the skill profile of workers moving out of one sector is so different from that wanted for the vacancies in expanding sectors that frictional un-

¹⁷ Edwards (1979, p. 32, Vol. II) for a similar 'suspicion'.

employment becomes structural. Finally, the overall climate of stagnant consumer demand and falling investment in the Community, on top of business insecurity about future energy prices and the borrowing capacity of important purchasers of EC exports (such as some LDCs, a few NICs and Poland, for instance) is not particularly conducive to smooth shrinking processes in comparative disadvantage sectors.

This has led to increasing pressures for protection especially in 'other manufactured goods', mostly against NICs but sometimes also against the US (in steel, synthetic fibre carpets) and others. Table 4 has to be considered with at least a global notion of the protection involved. This paper is not the place to deal with actual protection in depth. The extent and coverage, let alone the incidence, of today's protection is exceedingly hard to capture. The following evidence claims little more than illustrative information on some of the sectors listed in Table 4. Firstly, some indications of actual tariff protection can be provided. In an interesting paper Olechowski & Sampson (1980) have calculated the weighted average tariffs if one does not only look to official Tariff Schedules listing MFN tariffs,¹⁸ but also takes into consideration that the EC has a plethora of special trade agreements, including of course the Generalized System of Preferences, all lowering tariffs for the trading partners concerned. Though sectors are not identically defined as in Table 4, the impression that EC tariff rates for developing coun-

¹⁸ MFN tariffs are tariffs for imported goods from all countries that are contracting parties to GATT and therefore enjoy Most Favoured Nation treatment.

tries are very low is confirmed: wood and wood products, 1.6%; textiles and textile arts, 8.9% (but only 4.2% for developed trading partners); footwear and accessories, 10.1 (and only 3.3 for developed countries) and miscellaneous manufactured articles, 9.5%. Surely, these low tariffs even in sensitive goods cannot be a true hindrance for NICs.¹⁹

Secondly, a notion of various non-tariff distortions can be obtained by studying official documentation (note that this approach merely establishes a minimum estimate of non-tariff protection). Here, the picture changes dramatically. Olechowski & Sampson apply a frequency index indicating the (unweighted) share of the number of classification headings of goods on the four-digit level the imports of which are subject to some form of import control. The controls may be little more than early warning systems such as surveillance schemes (the EC had one for cutlery, a sector listed in Table 4); others could be quotas, licensing arrangements, import price controls (as in steel; at present only relevant for Spain and South Korea) and various officially agreed export restraints. Non-tariff distortions of the EC turn out to be very frequent and 90% of them are discriminatory. The share of discriminatorily 'controlled' trade items in the total number of four-digit items for 'wood and wood prod-

19 It should not be forgotten that this ignores so-called 'effective protection': the fact that tariffs are higher the higher the stage of production. It is known that the structure of effective protection (also) in the EC is significantly biased against processing of raw materials and production of semi-manufactures in LDCs. See Lal (1979) for an extensive empirical survey.

ucts' is 18.4%, for 'paper' (not listed in Table 4) 27.7%, for 'textiles and textile arts.' 75.4%, for 'footwear' 15.7% (which is one-third of the US rate) and for 'basic metal products' (like cutlery) 7.9%. Miscellaneous manufactured arts. have, however, only 3.7% of items 'controlled' (all figures for 1976). Other work confirms the sharp rise in EC protection vis-à-vis developing countries.²⁰⁾ According to Page (1980), 34% of EC manufactures' imports from developing countries in 1979 is, what she calls "mainly managed",²¹ which is higher than the OECD

²⁰See especially Nowzad (1978), Murray, Schmidt & Walter (1978) and Turner et al. (1980, p. 15). The following examples are taken from Nowzad (1978, App.s. X, XIII and XIV; manufactures only). At the end of 1977 Taiwan suffered from an import prohibition (!) in radio's (France), a license scheme in umbrella's (France) and a quota for umbrella's (Germany). In the 1970's South Korea suffered from a license scheme in footwear (United Kingdom) and quota for black & white t.v. sets (United Kingdom), for radio's (France; two temporary ones), for umbrellas (France; two temporary ones), for silk fabrics and for toys (France), as well as license schemes in cassette recorders and cutlery (Denmark). At the end of 1977 the Philippines suffered from a tariff quota in veneers and plywood (EEC; initial zero tariff). The list does not include protection under the Multi-Fibre Arrangement.

²¹Here, LDCs include the Middle East. Note that she applies 1974 trade figures to 1979 restrictions in order to avoid that the import value of controlled items would shrink due to such controls.

overall share.

Thirdly, there are the two Multi-Fibre Arrangements, preceded by the Long-Term Arrangement on Cotton Textiles. Over time these arrangements have become broader in product coverage and in coverage of 'Fibre' exporters (now 29 countries!), more stringent in terms, permit many more downward exceptions to the rule of 6% import growth and leave ever more diplomatic room for bilateral dictates.²² In textiles and clothing the EC has now become a champion in protection. Therefore it is truly remarkable that the four sectors listed in Table 4 still register import growth rates of 141% - 171% which is approximately double the 6% rule (including 10% average annual inflation). The explanation is to be found in the chances given to younger NICs facing less stringent controls than South Korea, Hong Kong and especially Taiwan in clothing and the relatively mild attitude towards Spain and Portugal, and a few young NICs in certain textiles. In textile yarn & thread, NICs like Turkey, Egypt, Argentina and Israël managed to increase their exports to the EC by 400% or more. In woven cotton fabrics it is especially Greece, Spain, Egypt, India and Thailand; in made-up textile articles it is South Korea, Portugal and Israël; in clothing, it is Greece, India, Thailand, Singapore and the Philippines. Established suppliers, on the other hand, see their exports increase by barely more than inflation.

In the case of textiles it is hard to tell whether we confront a NIC problem or a more general North-South problem. The essential distinction between the two is the import growth rate,

²²For excellent treatises, see Keesing & Wolf (1980) and Cable (1979).

once a substantial import level has been achieved. One gets the impression that the Second, and the soundings about the Third, Multi-Fibre Arrangement are basically attempting to maintain market shares for domestic producers. Hence, the concern is not about the rate of import growth, disrupting markets and seriously injuring local (EC) producers, but about the level of imports. The forms of protection chosen--quantitative, mostly-- seem to hint at such an inference as well. But that would point to very different underlying causes for protection.

Concern about the level of competitive supplies can be translated into concern of the levels of profits and wages, or about employment if capital/labour substitution would be shown to be irrelevant and NIC imports crucial. Hence, if we accept the results of many studies on the impact of LDC exports on employment²³ in the OECD economy (shown to be minimal), concern about import levels, and the resistance to even moderate increases of export shares of poor countries--NICs or not--point to issues of (domestic, not global) income distribution. In contrast, the NIC problem ought to be strictly related to the social, human and technical processes of adjustment that take time and should not become more costly than the gains from relying on cheap imports.

On the other hand, Table 4 and the material underlying it show clearly that even in textiles and clothing younger NICs still have switching possibilities that are not feasible for undeveloped countries with incidental clothing firms. It is the 'graduating' NICs the textiles and clothing exports of which are throttled.

²³See OECD (1979, Annex 2) for an extensive survey.

5. Adjustment to NICs and the Community's trade policy

The European Community, being a set of economies of the mixed economic order, may choose between three distinct methods of adjustment to manufactures imports from NICs: by market forces alone, by industrial policy or by trade policy. Although current practice clearly shows a reliance on some mixture of the three, it is useful for purposes of analysis to establish to what extent they are substitutes. In what follows, to be a substitute will not only refer to the effects upon (the direction of) industrial structural change, but also to the level and allocation of the costs of adjustment. In turn, these properties can be traced back to political processes in mixed economies, both nationally and at the Community level.

Given certain conditions, market processes lead to effective, early and continuous adjustment. In principle, markets are signalling devices and ignoring signals of declining sales or profits is penalized after some time. The effects on industrial structural change will be to have resources shift out of comparative disadvantage products into similar but higher value-added goods (existing, newly invented or differentiated) or into less similar, if not entirely different products. Specialization within the same industry is normally considered to be a less costly form of adjustment than shifting resources between industries. It is often claimed that market integration within the EC in the 1960's has been easy since it took the form of intra-industry specialization

in a large number of sectors. In an open world economy with unabated technological progress, the pressures for continuous adjustment to change are substantial and their origins complex. Markets simplify the monitoring of change by coordinating information and transforming it into signals that consumers, retailers and producers immediately understand.

A non-exhaustive list of conditions for markets to perform their tasks properly includes workable competition, reasonable predictability of demand and supply trends (or at least market agents ought to have that perception) and a fair degree of inter-regional and intersectoral mobility irrespective of age, of skill, and of cyclical downswings. If these conditions are approximated, market processes tend to minimize the costs of adjustment for the factors of production involved, tend to allocate these costs to the 'adjusters' and not to others, and tend to create, by awarding efficiency and superior performance, an incentive system for the persistence of competition and for new entrants (from anywhere).

This is essentially how market adjustment processes have functioned when national EC markets were opened up around the turn of the 1960's. When the Dillon and Kennedy Round, as well as a quantum jump in international direct investment, further internationalized the economies of member states, market processes were still treasured as an effective, least-cost method of adjustment. Apart from a weak attempt to respond to the American Challenge by a Community Industrial Policy in advanced technology, there was no call on substitutes. Quite the contrary, a liberal common commercial policy in manufactured goods was complementary in giving even more sway to the method of market adjustment.

Industrial policy, here defined for simplicity as a set of non-mandatory government incentives such as aid and discriminatory procurement to influence structural industrial change, has the effect of altering the speeds of various sectoral adjustments. Although there exists a number of strictly economic justifications for specific forms of industrial policy - they relate to the assurance of the adequate functioning of market adjustment - the practice of the 1970's²⁴ in the European Community moved away from such approaches in assuming more and more conservative overtones.. The Commission had to concentrate on rescuing the customs union, and with it the notion of undistorted competition throughout the Community, by pursuing a trial-and-error strategy of surveillance and prohibition of national aid schemes on the basis of art.s 85/86 and 92-94, EEC Treaty. Apart from the special case of shipbuilding, the sectors recurring are synthetic and natural textiles, clothing, footwear and steel. This industrial policy is quite an imperfect substitute for market processes of adjustment. National aid schemes tend to slow down, if not block, adjustment. The Community, its formal emphasis on the necessity of adjustment²⁵ notwithstanding, actually appears to get no further than the harmonization of the national degrees of slowing down adjustment.

²⁴ Apart from steadily weakening French indicative planning and Italian interventionism, industrial policy in the 1960's was mostly paper work, both at the EC and country level. The conspicuous moves by countries (Concorde, aluminium, gas, oil) were primarily related to economic security. Regional industrial policy also played a role.

²⁵ By such norms as : aid ought to be temporary, ought not to have capacity enlarging effects, etc.

The costs of such an industrial policy tend to be higher than in case of market adjustment for two reasons. First, the cumulative costs over time tend to be higher since relatively low-productivity sectors can remain longer in business or can afford to improve efficiency and performance later. Secondly, there is a penalty to efficient competitors, be they domestic or foreign, because their market shares will grow more slowly than otherwise. Aid to ailing producers therefore tends to undermine the incentive system for the maintenance of permanent efficiency and for new entrants. Also, the allocation of costs is at least partly shifted to non-adjusters like the rest of the domestic economy (via the budget) and to foreign suppliers. In defense of industrial policy it should be said that at least the domestic costs of subsidies are visible for politicians and public (and so perhaps subject to political pressures to minimize aid) and that price competition remains (so consumers do not suffer). Of course, other instruments such as government procurement from weak domestic producers do have concealed costs.

Trade policy can be effective in influencing the speed of adjustment of comparative (dis)advantage products. Within the EC the customs union implies the transfer of domestic jurisdiction on trade policy to common decision-making. Thus, trade policy has not served as an alternative for market adjustment in the early 1960's when market integration was in full process. But it can play a role as an alternative to market adjustment to world competition, or of industrial policy. The Common Market increasingly turns to conservative trade policy as a 'superior' option to either two. As Olechowski & Sampson (op.cit.) show, such protection

is heavily biased towards less-developed countries which, in manufactured products, often means the NICs. In fact the Community's common commercial policy (CCP) has a Janus face in that it benignly pursues the improvement of access for non-socialist LDCs (Lomé Treaties, Asean, Maghreb, Generalized System of Preferences) while using plain commercial power to extract export restraints as soon as their supplies call forth resistance to adjustment.

The costs of such a trade policy are higher than in the case of industrial policy but vary with the nature of the protectionist instrument ²⁶. If we concentrate on 'voluntary export restraints' (VER) imposed upon NICs, the costs will be higher for the domestic consumers (and this will outweigh the costs otherwise borne as taxpayers). Also, the penalty for NIC-producers is more severe as efficiency and performance cannot possibly improve their access, being quantitatively given. Since VERs are discriminatory, the victimized NICs observe their competitors penetrate the same markets, which deals another blow at the incentive system they believe they can usefully employ for development. If they then diversify successfully (with all the costs of adjustment) they may run into a new dead-end street. Finally, the costs of maintaining low-productivity sectors in advanced countries tends to be higher under VERs because market shares are even less likely to decrease than under industrial policy unless VERs apply to very few out of a multitude of suppliers and permit import growth. How-

²⁶ For a distinction between hard and soft protection on the basis of the level and allocation of the costs of protection, see Pelkmans (1980).

ever, if VERs quickly spread to all major suppliers and become stricter all the time, trade policy ceases to be an instrument of adjustment. Rather it becomes an instrument which shelters the unwillingness to adjust to NICs.

The political economy of adjustment to NICs in the EC is now easy to sketch in its contours. At the member state level, pressure groups that call for relief from the pains of adjustment cannot be helped through trade policy as the instrument is transferred to Brussels. Within limits, however, industrial policy is possible. The initially liberal trade policy of the EC meanwhile continues to create incentives for a series of NICs to export so that adjustment pressures increase in the sectors first aided and spread to other ones. Gradually, industrial policy becomes visibly expensive and is also likely to become incompatible with the customs union rules. Since the Commission can only forbid national aid but not replace it by Community aid, pressures shift eventually to the instruments the Commission can use : those of trade policy. The advantages to the various decision makers are substantial. The lobbies and pressure groups prefer the use of trade policy, especially the quantitative element of it, as it gives more certainty about the adjustment pressure to expect. The national politicians will be content because it will spare them the critique of noisy pressure groups - loudly attributing sectoral unemployment to the NICs - while relieving heavy budgetary pressures. The Commission, always eager to boost Community instruments, is in a bind, since it is independent enough to perceive the grave dangers of protectionism. Its accommodative reaction is often to go ahead with protection but soften the costs by allowing

for (say) 6% import growth, by minimizing the number of victim NICs and by permitting loopholes in the text ²⁷. This clever game of damage limitation pays off in commercial diplomacy and in its relation to the Council.

But the recessionary circumstances of the late 1970's have undermined the accommodative CCP. The Commission's lax and imperfect control of imports under the first Multi-Fibre Arrangement drew heavy criticism. Member states became more aggressive in requests, despite their trade pledge in the OECD. In 1977 France blackmailed the EC by installing unilateral quota's on several textile and clothing imports. In order to meet the threat to the customs union, the Commission had to follow suit. The Common Commercial Policy was bound to become protectionist towards NICs in order to rescue internal market integration. Nevertheless, quotas under the second Multi-Fibre Arrangement were subdivided and assigned to individual Member States, degrading the EC to something of a free trade area with renewed emphasis on certificates of origin at intra-EC borders.

The political economy of the present CCP is fraught with costly imperfections. The paramount failure is that the costs of slow adjustment are first significantly enlarged and subsequently shifted to 'non-adjusters' that have no say in the decision-making process! They include consumers and efficient firms in the EC using

27 Threatened NIC-producers can also be lured into restraints by allowing them to seize the rent. This can be done by giving rather than selling established producers the import licences.

imported inputs from NICs that are controlled, but above all they include the workers in NICs (their management too, depending on 'rents' and possibilities for export collusion). On the Community side it ought to be said that commercial policy making is dangerously hidden from the public and is out of control for national parliaments and the European one. Lobbies talk directly to Eurocrats and sometimes the latter lean on the expertise of the former in international fora or negotiations. Until now the process has not slipped out of hand completely due to the interest some member countries still have in exports within the category of 'other manufactured goods', including footwear, travel goods and handbags (Italy) and textiles and clothing (Germany, Italy).

On the NICs side, it is increasingly realized that bargains are becoming impossible. One can defend consultations between NICs and the EC about development plans that focus on key export products in need of market access to the Community (Hager, 1980), avoiding 'rifle-shot' incidents. One could even argue that a selective safeguard-clause in the GATT to deal with market disruption is superior to its present art. 19 (that is non-discriminatory), if only it were temporary in application and under multilateral surveillance, ensuring minimal costs to NICs. But it is a sham to compel NICs to 'agree' to VERA that are unilateral quotas in all but name.

It is the good fortune of the NICs as a group that present trade policy in the EC is little more than a 'fire brigade'

activity²⁸. Time is fully consumed by extinguishing fires in commercial diplomacy or in intra-EC bargains on the nitty-gritty product level. As we have seen in section 4, policy being discriminatory and product-by-product, the dynamism of young NICs in textiles and clothing, and of all NICs in products where protection does not yet cover the 'up-market' goods, still beats the CCP. Where it does not, it is the recessionary demand (synthetic fibres, certain steel semi-manufactures) rather than the CCP which seems to be the primary cause.

6. Improving the Community's relations with NICs

The European Community has substantial interests in rapidly improving commercial relations with Newly Industrializing Countries. The EC ought to develop a long run commercial policy vis-à-vis the NICs based on a profound investigation of the international and domestic, political and economic costs and benefits of alternative strategies. The case for a liberal and adaptive policy embedded in a well-developed diplomatic framework of conflict management is a strong one. It rests on two sets of interests for the Community, still apart from the interests of the NICs.

The first set of arguments has to do with the costs of the current policy, sliding ever more into a plain servant of low-productivity, high costs producers' lobbies. Not only do the diplomatic and political frictions caused by shifting the costs of the unwillingness to adjust onto relatively poor trading partners lead to harmful attitudes and stiffened NIC-protection,

²⁸ Expression of an EC trade policy official in private discussion with the author.

the Common Market bears heavy domestic costs as well. These costs include the static losses from misallocations, the losses of efficiency in sheltered firms and the elusive, but ultimately crucial loss of dynamism as the incentive system for efficiency and performance is consistently penalized by aid schemes and protection to non-performers. In an interesting study (EC, 1979, ch. III, 5) it is shown that the Community has a fair record up to the mid-seventies in adjusting to global structural change. The Japanese example is superior, however, and underscores the importance of anticipating and facilitating adjustment rather than accommodating low-productivity sectors.

An obstacle for a market oriented Community adjustment policy is the separation between industrial and commercial policy. There seems to be no sensible economic reason why 'Internal Market' and 'Industrial Policy' are resorting under one Directorate-General, whilst trade policy, being a partial substitute for the latter, has no organic link with it. Even the mere negative competences of the Commission in industrial policy could be applied with explicit reference to adjustment clauses in trade policy agreements. Toughness in judging aid schemes does not square with shambles in trade measures in (often) exactly the same sectors.

The second set of arguments has to do with commercial power. Commercial power vis-à-vis the NICs can no longer be taken for granted. The EC has been lulled by the ease with which it played the bilateral, sectoral power game after generally agreeing on the Second Multi-Fibre Arrangement in early 1978. Basic to the commercial power relation between NICs and the EC is the asymmetrical importance

of mutual trade to overall domestic economic activity for the two parties. As Table 3 and other data clearly suggest, access to the EC is much more important to the NICs than the NIC-trade is for the EC. There still is not one single sector, as defined in Table 4, in which the share of no less than 16 NICs is larger than the share of intra-EC imports in total imports (although some sectors in 1979 came rather close). The share of NIC-imports in EC production would be even lower ²⁹.

But other power factors have changed in the late 1970s. Though the big surplus of the EC in manufactures' trade with NICs is relatively decreasing, this is predominantly due to Spain, South Korea and Taiwan. With Hong Kong the EC run a deficit in 1979 but recent growth rates of EC exports to Hong Kong were much higher than those of imports. Other NICs provide the Community with a comfortable surplus, that enhances the Community's vulnerability in times of heavy overall deficits. NICs could start exploiting this.

More important, however, is the stake in the volume EC-NIC trade has now reached. Is it realized in Brussels that EC 1979 imports from (16) NICs in 'machinery and transport equipment' and in 'other manufactured goods' amounted to 93% of those from the

²⁹ See, for some examples of disaggregated sectoral import/production ratios, Nowzad (1978, p. 105). The 1976 ratios for French imports from all LDCs never come above 16%. For import penetration rates (see fn. 3) of some clusters of two-digit sectors, for the EC, in 1975, see UNCTAD, 1979, Table 7.1. For manufactures from all LDC's they never reach beyond the 7% of clothing.

US, up from 68% in 1975? Has one observed that the 1979 exports of 'machinery and transport equipment' of the Common Market to 16 NICs are one-third higher than those to the US? Is it known that EC 1979 exports in 'other manufactured goods' to the US and to the NICs are at par while EC chemicals exports to NICs are nearly one and a half times higher than those to the US? Even if Japan and the US are combined, EC 1979 exports in chemicals and in 'machinery and transport equipment' to NICs are still equal or larger than to these big traders.

These stakes in trade are not in the least reflected in the conduct of commercial policy. With the US and Japan complex bilateral networks of information and regular consultation have been built up, including the highest political level in world economic summits, and incorporating multitudinous contacts in multilateral fora such as GATT and the OECD (and its Steel Committee, for instance). For NIC-EC trade such a framework is lacking altogether. Contacts are occasional and the style of diplomacy reminds one of old-fashioned tariff wars. The EC may even be forced into more regular consultation and bargaining on equal footing if the NICs were to found a common organisation. Such a "NIC-caucus" would not be easy to set up but the formation of an effective coalition of Lomé-associates has shown that it is a realistic possibility. A tightly managed NIC-caucus would have several powerful weapons. It could bring in more authority by blocking the Community's bilateral approach to NICs. It could also bargain over a wider scale of products than any single NIC could do. Its ultimate weapon would be a buyer's boycott on selected products in view of the sizeable EC surplus. A more subtle route

could consist in discriminatory retaliation with simultaneous offers for trade liberalisation in response to blatant forms of EC protectionism. Since the NICs, except Singapore and Hong Kong, are highly protectionist themselves, there is ample room for organizing countervailing power. Finally, a NIC caucus could facilitate prior consultation about development plans with a view of preventing 'rifle-shot' incidents.

It is highly desirable that a more adequate management of EC-NIC trade relations be established, reflecting an awareness of the costs of the recent inward-looking commercial policy and of the substantial and growing stakes the Community has in trading with Newly Industrializing Countries.

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