

THE ASSOCIATION SYSTEM OF THE EUROPEAN ECONOMIC COMMUNITY
AND ITS IMPACT ON INTERNATIONAL TRADE POLICIES

by

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I declare that the whole thesis, unless specifically indicated to the contrary in the text, is my own original work.

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LIST OF ABBREVIATIONS

AAMS	Associated African and Malagasy States
BSL	Botswana, Swaziland, Lesotho-
CAP	Common agricultural policy
CET	Common external tariff
COMECON	Council for Mutual Economic Assistance
ECSC	European Coal and Steel Community
EEC	European Economic Community
EFTA	European Free Trade Association
GATT	General Agreement on Tariffs and Trade
GSP	Generalized Scheme of Preferences
ITO	International Trade Organisation
LAFTA	Latin American Free Trade Area
LDC	Less-developed countries
OECD	Organisation for Economic Co-operation and Development
OEEC	Organisation for European Economic Co-operation
UDEAC	Union douanière et économique de l'Afrique Centrale
UNCTAD	United Nations Conference on Trade and Development

The term 'Association' describes the Association system of the EEC.

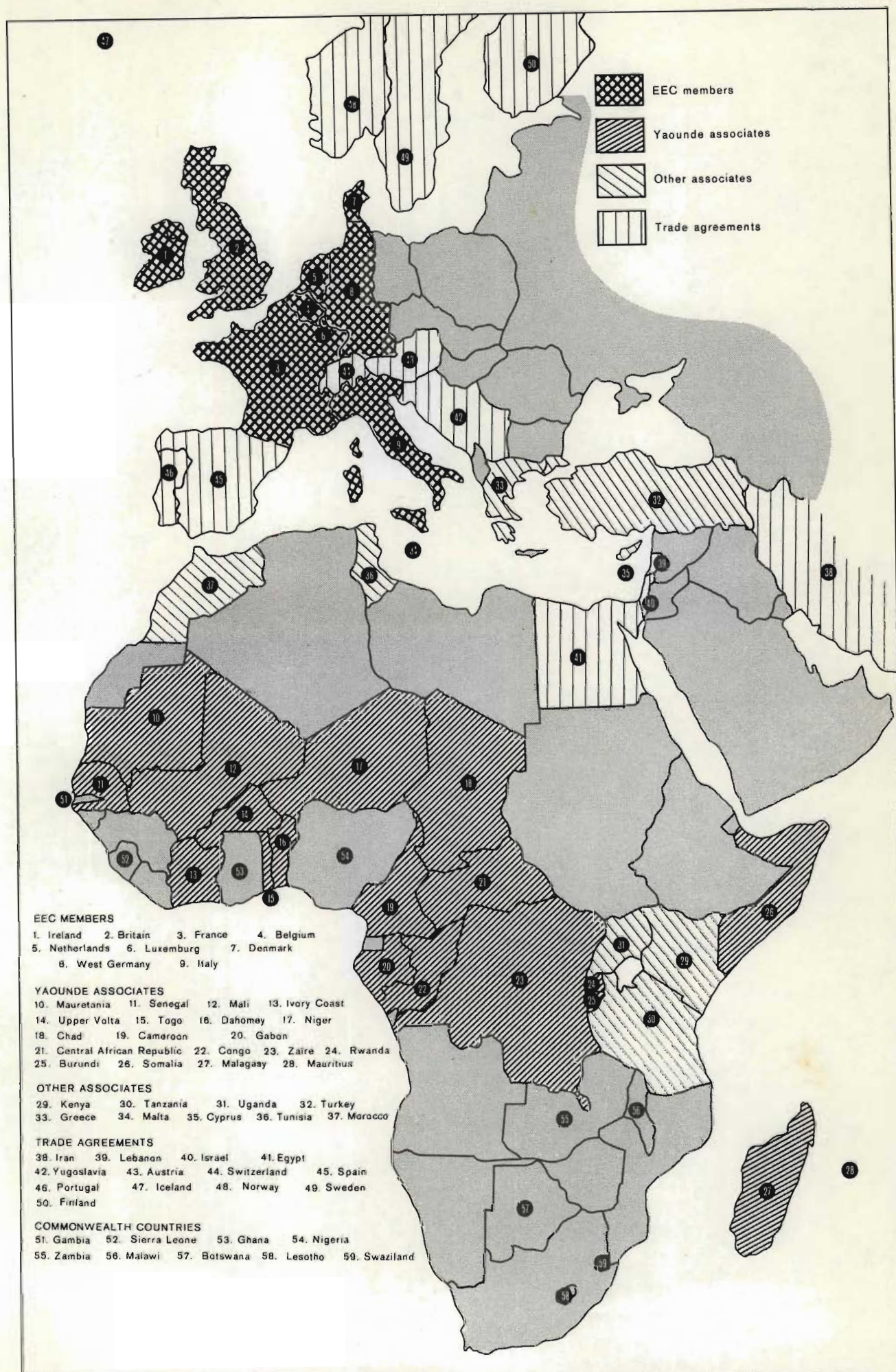


Fig. 1. The European Economic Community and the Association System

INTRODUCTION

In March 1957, six European countries embarked upon a momentous course which is leading them towards economic integration and may eventually link them politically: France, West Germany, Italy, Belgium, the Netherlands and Luxembourg signed the Treaty of Rome establishing the European Economic Community. In January 1973, Britain, Ireland and Denmark joined the Common Market, thus increasing the Community to nine members.

Although the arduous process of integration and the concomitant changes in internal relations are the most important aspects of this venture for members of the Community, countries remaining outside the EEC are more concerned with the external policies of the Common Market. A prominent aspect of these external relations is the Association system which describes the complex network of association and trade agreements between a number of countries and the EEC. Thus, the Association system will be taken here in its broadest sense, to include not only associated states but also countries which have entered into simple trade agreements with the EEC.⁽¹⁾

The central theme of this thesis is to consider the impact of the Association system of the European Economic Community on international trade policies. The basis for Association resides in Articles 131-136 of the Treaty of Rome.⁽²⁾ The purpose of these provisions was to deal with the problem of dependent territories of the Six members of the Common Market. In 1957, France possessed a large colonial empire, mainly in Africa, while

(1) See map on p. xi.

(2) In conformity with current usage, the term 'Association' refers to the Association system of the European Economic Community. See Annex A for relevant Articles of the Rome Treaty, 1957.

Belgium, Italy and the Netherlands also had dependencies in various parts of the world. France, in particular, refused to proceed with the EEC negotiations unless some arrangement was agreed upon to allow her to maintain the close economic and social relationship which she had with her colonies. The full application of the terms of the Treaty of Rome to those dependencies was rejected by the other members of the Common Market, but a compromise was reached in the concept of Association between the EEC and dependencies of the Six.

The most important aspect of the Association was the creation of a free trade area between the EEC and the associates, giving preferential access to exports from both groups into the markets of the Common Market countries and of the dependencies. In addition, financial aid was to be provided for economic and social projects, through a European Development Fund, to which all members of the EEC were committed to contribute. Underlying these economic factors was the political aim of maintaining close links between the Western world and African countries on the brink of independence, especially in view of the fact that some EEC members had large investments in those territories.

In 1963, a new type of Association was agreed upon between the EEC and eighteen independent African countries. Since then, the Association has so evolved as to include other types of agreements, some establishing a limited form of association and others dealing only with commercial relations. Therefore, the Association system extends to many other countries besides the original associates.

The focus of this thesis is Africa. Although the EEC has entered into agreements with countries in Europe and other

parts of the world, most associates are African states, and the most important agreement is the Yaounde Convention of 1963 and 1969, between the Six and the Eighteen.⁽¹⁾ The accession of Mauritius has increased the number of full associates to nineteen.

A number of Commonwealth countries have recently become associates of the EEC and the convergence between the Commonwealth and the Association is blurring the old division between franco-phone and anglophone Africa. This trend will be accelerated if other Commonwealth countries become associated with the Community following Britain's accession to the EEC.

South Africa's trade relationship with the Community has been affected by the enlargement of the EEC. Preferences which have benefitted South Africa's exports to Britain since the Ottawa agreements of 1932 will be abolished and the South African Customs Union might be altered if Botswana, Swaziland and Lesotho become associates of the Common Market.

Apart from its effect on Africa, the Association system has had an impact on wider aspects of international trade. Since its inception, the Association has been criticized by third countries⁽²⁾ because it was argued - inter alia - that it would damage the external trade of non-associates, especially developing countries. It has also been maintained that the terms of the Association and trade agreements are in conflict with the rules of the General Agreement on Tariffs and Trade. Preferences given by the EEC to associates have induced other developing countries to obtain tariff concessions in the markets of developed nations.

(1) As the 'Six' refers to the original Common Market countries, the 'Eighteen' is currently used to describe the eighteen dependencies of the Six, which became associates in 1963.

(2) Similarly to current publications, the term 'third country' is used to mean a country not party to a particular agreement. With regard to the Association, third party thus refers to a country which is neither a member of the Association nor an associate.

This has resulted in the establishment of the Generalized Scheme of Preferences which has contributed to the failure of the principle of non-discrimination of the GATT.

The controversy which affects several aspects of the external relations of the European Economic Community are related to the basic disagreements between nations on the role and function of international trade. Differences of opinion in this respect will persist as long as countries differ in economic structure, patterns of trade and development.

Our purpose is therefore to examine the impact of the Association on these various aspects of international economics. The sector of economic theory most closely related to these problems began as a branch of tariff theory - the theory of customs unions - investigating the production and consumption effects of the elimination of tariffs between partners of a customs union. It has recently been extended into a theory of economic integration which broadens the field of international trade theory by considering effects on growth and on governmental policies.

A survey of these theories suggests that although the basic theory of customs unions was inconclusive as to whether it results in gains or losses for the countries concerned, the extension of the theory points to a presumption in favour of integration, even if these benefits remain immeasurable. Although the external trade patterns of Associates can be examined and compared with those of other developing countries, the present

state of economic theory does not allow any prediction on whether the Association system will promote the economic and social development of the countries concerned.

The effects of economic integration may be examined from four viewpoints:

- a) the individual countries concerned;
- b) the integrated group as a whole;
- c) outside countries;
- d) the world as a whole.

Most of customs union theory has been concerned primarily with the viewpoint of individual countries (a), but occasional reference has been made to the integrated group (b). The viewpoint (c) that is to say, the effects of integration on other countries, has not attracted much attention except for some discussion on their terms of trade and their right to compensation should the establishment of a customs union cause damage to their economies. The impact of integration on the world as a whole (d) has seldom been discussed and it is certain aspects of this problem which is the main concern of this thesis.

Chapter I will deal with theoretical aspects of international trade and different types of economic integration and Chapter II will consider the contribution of economists to the theory of customs unions and its extension into new fields, including non-economic aspects. The Association system will be discussed in some detail in Chapter III and the significance of the Commonwealth Associates in Chapter IV. An empirical analysis

of the trade of the EEC with the Associates and the special problems of South Africa's trade with the EEC will be examined in Chapters V and VI.

The second part of the thesis will be concerned with the impact of the Association on broader aspects of international economics. A discussion of the GATT's views on the preferential aspect of association and trade agreements, and on tariff preferences generally (Chapter VII) will be followed by an outline of the development of the Generalized Scheme of Preferences and the part played by the Association in this respect (Chapter VIII). The GATT has failed to maintain non-discrimination in international trade (Chapter IX) and this is only one of the sources of conflict among the trading nations of the world (Chapter X). The Conclusions will be contained in Chapter XI.

It must be stressed that the Association system of the European Economic Community is a dynamic part of international trade and subject to frequent changes. In view of this fact, this thesis will not consider alterations which have occurred after 1st January, 1974.

CHAPTER I

THEORETICAL CONSIDERATIONS

International trade theories - comparative advantage - factor endowment theory - tariff theory - effects of tariffs on the economy - on terms of trade - economic integration - different types of integration - economic co-operation.

The European Economic Community has entered into association and trade agreements with a number of developing countries, mainly in Africa. Although some of these agreements include provisions for technical and financial assistance from the Common Market, the main reason for these arrangements is to facilitate trade by removing tariff barriers between the European Community and those countries. Countries have joined the Association in the hope of benefitting from increased trade with the EEC. Thus, this move may be looked at from two points of view: international trade and economic integration.

The purpose of this chapter is to provide a theoretical background to an examination of the Association system of the EEC. We shall therefore outline international trade theory, then proceed to a discussion of customs unions theory and finally examine economic integration as a trade policy.

A. INTERNATIONAL TRADE THEORIES

Early theories of international trade were based on the labour theory of value and therefore the value of goods was calculated in labour costs, man-days or man-years. Adam Smith pointed out in

1776 that trade occurs because of division of labour and specialization and that this is brought about by the fact that certain countries possess advantages over others. For instance, if country A is able to produce commodity X more cheaply - that is, with less labour - than country B, whilst country B produces commodity Y more efficiently, then an exchange of goods X and Y will benefit both countries. The law of absolute advantage, as this was called, was superseded in 1817 by David Ricardo's law of comparative advantage. In his 'Principles of Political Economy' Ricardo showed that it was not necessary for a country to have an absolute advantage in the production of a commodity in order to benefit from international trade. If the country has a comparative advantage in one commodity over another, it will benefit from trade with another country with an opposite pattern of relative advantages. There is no need to reproduce here in detail Ricardo's famous example of two countries producing wine and cloth. Briefly, country A produces both commodities with less labour-costs than country B, but while A is relatively more efficient in the production of wine than cloth, B is relatively better at producing cloth than wine. Both countries will benefit by exporting the commodity in which it has a comparative advantage and importing the other product.

Although the Ricardo model comprised only two countries and two goods, it was shown later to be applicable to a larger number of countries and products. The assumptions were that there was only one factor of production (labour), perfect mobility of factors within a country but imperfect mobility of factors between countries, and no account was taken of the demand for goods nor of transport costs.

John Stuart Mill, during the mid-19th century, examined possible terms of trade by focussing attention on the demand aspect of international trade. He reconsidered Ricardo's example of comparative advantage by assuming a given amount of labour and different outputs, instead of different labour costs for identical outputs. This led Mill to formulate the law of reciprocal demand which indicated that the ratio at which commodities would be exchanged - the terms of trade - depends on the strength and elasticity of each country's demand for the goods produced by the other country.

To complete this brief survey of classical theories, mention must be made of F.W. Taussig who, in 1927, considered interest on capital and the existence of non-competing labour groups and their effect on international trade.

Moving away from a model using one factor of production, Haberler (1933) used the concept of opportunity-cost to elaborate on the theory of comparative advantage. This showed that the resources of a country could be used for the production of either A or B, or varying amounts of each, so that the cost of producing A could be measured by the amount of B which must be given up in order to produce A. Haberler also stressed the fact that countries with identical inputs were able to produce outputs of differing amounts.

The question of differences in efficiency remained unanswered, however, until Bertil Ohlin, following in the footsteps of his teacher Heckscher, put forward the factor-endowments theory in 1933. Different commodities require different proportions of certain factors of production. Thus countries with relatively large areas of land are better suited to land-intensive production and countries with large labour resources relative to capital are better suited to labour-intensive production. Thus, while Ricardo made

technological differences the main reason for trade, Ohlin's model showed that trade occurred because of differences in relative factor-endowments and therefore, differences in factor prices.

Ohlin assumed perfect competition, factor mobility within a country but factor immobility between countries, no barriers to trade, no transport costs and identical technology in all countries. These assumptions made Ohlin's model somewhat unrealistic, and gave rise to certain criticisms of his theory.⁽¹⁾ Among these is the fact that it is sometimes difficult to decide whether a product is capital-intensive or labour-intensive without investigating the possibility of factor-substitution, since there is often a range within which one factor can be substituted for another factor in order to produce a specific commodity. Another criticism is that the units of factors of production are not homogeneous. This was first pointed out by Taussig with regard to labour, but other factors of production are also made up of non-competing groups. Some land is suitable for the production of a certain crop and not another, and labour may be efficient at a certain type of work but not so efficient in other activities. Thus if factors of production are defined narrowly and non-competing groups are considered as separate factors, 'it turns out that much trade is based on absolute advantage, the existence of a factor in one country but not in its trading partner'.⁽²⁾

International trade tends to equalise factor prices. This occurs since exports tend to raise prices of the plentiful and cheaper factor, whereas imports tend to lower prices of goods produced by the scarce and expensive factor of production and hence

(1) See inter alia, Charles P. Kindleberger, International economics, Homewood, Richard D. Irwin, 1968 (4th ed.), pp. 29-31, and David Young, International economics, London, International Textbook, 1969, pp. 29-37.

(2) C.P. Kindleberger, *ibid*, p.30.

the price of that factor. However, complete equilibrium will not be reached because many other influences and barriers will distort the mechanism.

'The statement that the tendency of trade is to equalise factor prices internationally, it has been found, must be qualified in several respects. The difference in quality between productive factors in different countries, the possibility of using entirely different technical processes, the economies of large-scale production, and differences in economic stability and taxation not only blur the outlines of the previous analysis, but make it uncertain to what extent international trade as a whole actually tends to equalize factor prices.'⁽¹⁾

Although Ohlin's model assumed immobility of factors internationally, he went on to consider the effects of factor movements between countries, on factor prices. Thus he showed that there was no basic difference in the mechanics of interregional and international trade. In the European Economic Community, international trade becomes more obviously interregional trade as tariff barriers to the movement of goods are progressively eliminated. However, transport costs and other differences prevent full equalization of factor prices and therefore of commodity prices also.

Modern analyses of international trade have tried to take into account a variety of factors which affect costs and prices in world trade, not only transport costs, but also internal and external economies, differences and changes in tastes, managerial ability, competition or monopoly and differences in technology. As it is not our purpose to give a complete list of recent approaches in international trade theory, we shall only mention two of them: the technological gap and the 'vent for surplus' theory.

(1) Bertil Ohlin, Interregional and international trade, Cambridge, Harvard University Press, 1935, p.113.

The technological gap between countries (sometimes called the imitation gap) may alter the pattern of international trade. A country with a technological advantage becomes the pioneer in the production of a certain commodity which it exports to countries less advanced in this field. As technology improves all round, however, the first country will move towards the production of a technically more advanced product whilst the second country will begin to produce the original commodity, and in some cases eventually exports it to the pioneer country. For example, Japan exported transistors, an American innovation, to the United States. Thus because of technological differences, innovation leads to exports and in due course, imitation abroad leads to imports.

The 'vent for surplus' theory is of special interest to developing countries.⁽¹⁾ This approach originates from a point made by Adam Smith, but neglected by economists until recently. The classical trade theory assumes that the resources of a country are fully used before trade, and that with trade there is simply a re-allocation of these resources between the different uses. On the other hand, the vent for surplus theory acknowledges the fact that some resources may be idle before trade, and only drawn into production when the opportunity to export arises.

Among the barriers which distort the free mechanism of international trade are those included in the commercial policies of nations and which comprise tariffs and non-tariff barriers,

(1) See H. Myint, The 'classical theory' of international trade and the underdeveloped countries, The Economic Journal, Vol. LXVIII, no.270, June 1958, pp. 317 - 337.

Although some non-tariff barriers are clear and specific (e.g. quantitative restrictions) most others are difficult to define and control. These include escape clauses, anti-dumping practices, customs valuations, government procurement policies, state-trading, border tax adjustments, and do not lend themselves easily to theoretical analysis.⁽¹⁾ Tariffs, on the other hand, are the subject of an important section of international trade theory, tariff theory, some aspects of which are examined below.

B. TARIFF THEORY

Tariffs may be analyzed from the point of view of their impact on various aspects of the economy. These include effects on redistribution, protection, revenue, consumption, terms of trade, competition, income and balance-of-payments.⁽²⁾ The first four of these are demonstrated in Figure 2.

DD and SS are the demand and supply curves of a particular product in the importing country. In the absence of trade, the price would be at P". With free trade and assuming perfect elasticity of supply of foreign goods, the price is brought down to P, where OQ is produced locally and QQ₃ is imported. An import tariff PP' will cause the price in the importing country to rise to OP', local production increasing to OQ₁ and imports decreasing to Q₁Q₂.

(1) See R.E. Baldwin, Non-tariff distortions of international trade, Washington. The Brookings Institution, 1970; M.S. Massell, Non-tariff barriers as an obstacle to world trade, in D. Thompson (ed.), The expansion of world trade: legal problems and techniques, The British Institute of International and Comparative Law, 1965, reprinted in a slightly abbreviated form in H.B. Thorelli (ed.), International Marketing Strategy, Harmondsworth, Penguin, 1973, pp. 71-82.

(2) C.P. Kindleberger, International Economics, Homewood, Illinois, 4th Edition, 1968, p.105.

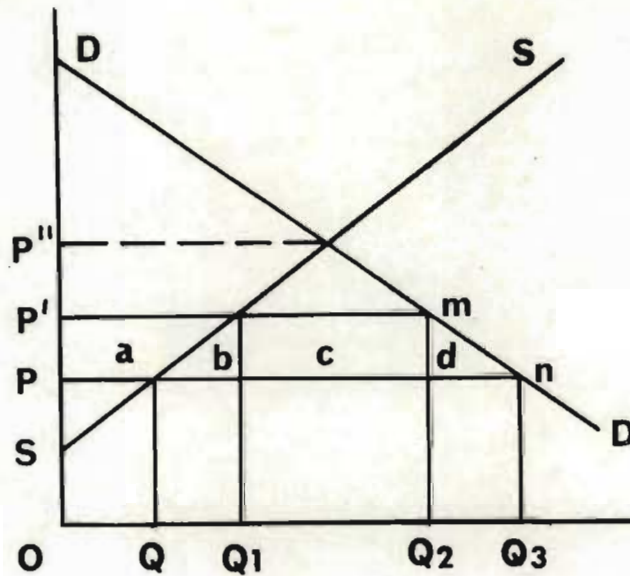


Figure 2. Effects of a tariff

Before tariff, consumers paid $OPnQ_3$, and satisfaction gained is illustrated by $ODnQ_3$. Their net satisfaction was therefore PDn . After tariff, they pay $OP'mQ_2$, and receive $ODmQ_2$. Net satisfaction: $P'Dm$. The difference (loss) to the consumers is therefore $PP'mn$. An examination of the components of this area leads to the following conclusions.

Redistribution effect: Producers' receipts have been increased by area a, and this represents a transfer from consumers (who pay the higher price) to local producers (who are able to charge the higher price). It is sometimes called the transfer effect.

Protective effect: Area b represents that part of increased receipts which has to be used to pay for increasingly inefficient use of resources. Assuming full use of resources before the imposition of the tariff, this is a net loss to the country.

Revenue effect: This is illustrated by area c which is the amount of import duties collected by the government of the importing country. It is sometimes assumed to be redistributed to the community in form of lower taxes (or in some other form) and would then be another transfer.

Consumption: Area d represents the loss of satisfaction of consumers (due to increased prices), not otherwise accounted for. It is, therefore, a net loss to the consumers and to the country as a whole.

Effects of tariffs on terms of trade may be similarly analyzed. A tariff imposed on imports will tend to raise the price of the good in the importing country and lower the price of that good in the exporting country, thus improving the terms of trade of the country imposing the tariff.

Figure 3 illustrates the supply and demand of a good in A (importing country) and B (exporting country). Under free trade, the price in both countries will be P_1 .

At price P_1 , A imports $MN (=M'N')$ and produces P_1M locally. A tariff T will partly increase the price of the imports, reducing the quantity to $QR (=Q'R')$. This will depress

the price in B. Prices will settle at P_2 in A and at P_3 in B, where the difference between P_2 and P_3 is equal to T . Country A will therefore benefit from an improvement in the terms of trade with B, due to cheaper imports from B.

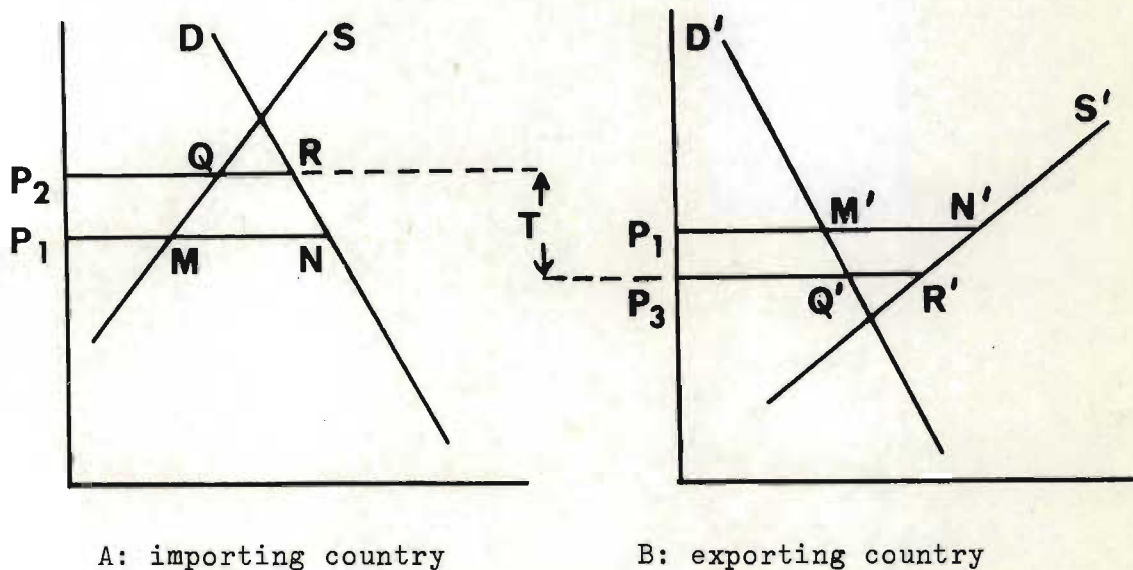


Figure 3: Effects of tariffs on terms of trade

The significance of tariffs in international economics has altered somewhat in recent years. Their importance as obstacles to trade has been reduced for the following reasons:-

a) Since the Kennedy Round of the GATT (1964-67) the average tariff on industrial goods (except textiles) has reached an all-time low of 12% or below.⁽¹⁾

b) Non-tariff barriers have increased in importance, not because they are new but because their effectiveness in limiting imports has become more apparent and it is often easier to use them than to raise tariffs.

(1) Thomas B. Curtis and John Robert Vastine, Jr., The Kennedy Round and the future of American trade, New York, Praeger, 1971, p. 227.

c) Monetary factors have increased their impact in international economics.

d) Finally, if we consider European trade, the establishment of a free trade area between sixteen nations - the nine EEC members and the seven EFTA countries - will contribute to a lessening of interest in tariff problems within Western Europe.⁽¹⁾

On the other hand, tariffs have maintained their impact in two fields:

a) In multilateral trade negotiations, they are a useful bargaining tool susceptible to quantitative measurement and comparison, and hence the GATT Rounds have concentrated on reciprocal tariff concessions.

b) Tariffs lend themselves to theoretical analysis and have been the focus of attention in early writings on customs union theory, since the elimination of tariffs between a group of countries and the establishment of a common external tariff on imports from outside, are the two essential characteristics of customs unions.

Customs unions are only one of the many forms of economic integration and before examining customs union theory in some detail (see Chapter II) it is worthwhile to consider economic integration and its evolution, in a broader context.

(1) In 1960, there were seven members of EFTA (Britain, Denmark, Norway, Sweden, Switzerland, Austria and Portugal). Finland and Iceland increased the membership to nine a few years later, but with the withdrawal of Britain and Denmark, EFTA once again comprises seven countries.

C. ECONOMIC INTEGRATION AS A TRADE POLICY

Economic integration is a recent development in international trade, both as a trade policy and as a field of study.

'The theory of economic integration can be regarded as a part of international economics, but it also enlarges the field of international trade theory by exploring the impact of a fusion of national markets on growth and examining the need for the co-ordination of economic policies in a union.'⁽¹⁾

(1) Evolution of economic integration

International trade policies vary with time and circumstances. The pendulum swung from the protectionism of the mercantilist period to the laissez-faire policies of the 19th Century and back again to restrictionism at the beginning of the 20th Century due to the resurgence of nationalism. A severe depression and two world wars disrupted the world economy and efforts have been made in the last twenty years to return to freer trade.

Endeavours to restore stability in international economic relations took place on a global as well as on a regional scale. The United Nations, the International Monetary Fund, the Organisation

(1) Bela Balassa, The Theory of Economic Integration, Homewood, Richard D. Irwin, 1961, p.3.

for European Economic Co-operation and the European Recovery Programme were all parts of this movement. More closely connected to international trade was the International Trade Organisation - which was never ratified - and the General Agreement on Tariffs and Trade which has achieved a fair amount of success in trade liberalisation since the first conference in Geneva in 1947.

On a regional scale, the growing realisation that integration might be beneficial led some countries to investigate the possibility of some form of regional integration. There were two motives: politically, it was felt that closer links would increase the strength of their position among nations, and economically, integration was sought because it increases prospects of growth by widening the market and improving the scope for economies of scale and specialisation.

Although customs unions existed before the last world war, it was only during the fifties and sixties that economic integration gathered significant momentum in international trade.⁽¹⁾ The practicability of establishing such unions, however, was considered doubtful by economists of the protectionist era.

'When one reflects how difficult it often is, even in a unified state, to fix upon a tariff, owing to the conflict of wishes and opposition of interests of the various parties concerned, and when one remembers what a painful process it was to get an agreement between the two halves of the old Austria-Hungary, despite the bonds of a common monarch and a common army, one is forced to the conclusion that, apart from exceptional cases, these problems are practically insoluble.'⁽²⁾

(1) The German Zollverein (1834), the South African Customs Union (1910), and the Economic Union between Belgium and Luxembourg (1921).

(2) Gottfried von Haberler, The theory of international trade with its application to commercial policy, London, W. Hodge, 1933, (English translation, 1950), p. 391.

After the war, efforts were made to liberalise trade and reduce nationalism. The results of international co-operation, however, proved disappointing. The ITO failed, while the evolution of the Council of Europe and the OEEC foiled the hopes of those who sought greater unity in Europe. On the other hand, arrangements between a smaller group of countries - Benelux - were progressing favourably. In 1951, the Treaty of Paris was signed, establishing the ECSC, between the Six. Soon after this, the European Economic Community and then the European Free Trade Association were formed in Western Europe, followed by COMECON in the eastern part of the continent. The African and Latin American integration schemes took shape in the following decade, as also the Association system of the EEC. As is well-known, integration in Western Europe took two distinct forms: the loose arrangements of EFTA, establishing free trade in industrial goods only, and the closer integration of the economic union of the Six. The two groups have now been linked by a series of trade agreements. Thus economic integration can take different forms.

(2) Different forms of economic integration

Economic integration is a process combining divided national economies into a single economy. The first stages involve the removal of discriminatory measures between countries and the more advanced steps include the co-ordination of various national policies into common policies.⁽¹⁾ Some countries never proceed beyond the first stage while others integrate more fully. There are therefore different degrees and forms of economic integration. The process may be illustrated as follows:

(1) These have been called 'negative' and 'positive' integration by J. Tinbergen, International economic integration, Amsterdam, Elsevier, 1954, p.122.



Fig. 4. The process of economic integration

A free trade area is the simplest form of economic integration. The countries involved eliminate tariff barriers on the movement of goods between themselves but they retain their own tariffs against goods from outside the area. Examples of this type of integration are the European Free Trade Association and the free trade arrangements between the EEC and the Association of African and Malagasy States, which will be the main topic of discussion in subsequent chapters.

A customs union has two characteristics: the elimination of tariff barriers on the movement of goods - as in a free trade area - and in addition a common external tariff on goods from outside the customs union. Thus it can be said that the customs union goes one step further than the free trade area. It establishes a common policy which requires agreement from the members of the union as to the type and extent of tariffs which will be applied. The nearest example, already mentioned, is the customs union between South Africa, Swaziland, Lesotho and Botswana which has been in existence since 1910.

In a common market, there is free movement of all factors of production, that is, not only of goods, but also labour and capital. The EEC is often described as a common market although there still exist barriers to the movement of capital in the Community, nevertheless some writers prefer to call it an economic union.

An economic union includes the characteristics of the common market but in addition there is co-ordination of national economic policies, which may necessitate harmonization of social, fiscal and monetary policies. The EEC has harmonized policies in agriculture and external commercial relations and is currently establishing common policies in other sectors.

It may be controversial to place the political union at the end of the process, and some may prefer to consider this form of integration as total economic integration, but complete integration in all spheres of economic activity presupposes a supra-national authority of such wide powers that it could only operate in a political union.

Although the above suggests integration as a gradual process from one form to another, this pattern is not always followed. The EEC proceeded straight away to a customs union without first establishing a free trade area. In other words, the Six began to harmonize their common external tariff at the same time as eliminating tariff barriers between themselves. On the other hand, the Community has established common policies and can therefore be said to be an economic union, although - as mentioned above - restrictions on the movement of capital persist in some parts of the Community and therefore there is no common market in the exact sense of the term.

It may be asked where the monetary union should be placed in the integration process and one may be tempted to set it either before or after the economic union. However, the South African Customs Union is also a monetary union but as there are no plans to free the movement of labour it is not a common market; the economic union between Belgium and Luxembourg has a common currency,

but did not envisage a common agricultural policy until the EEC was established; the economic union of the EEC, on the other hand, may be a long way from achieving a common currency. In fact, the circumstances are such that a monetary union in Europe may well require some form of political union because of the far-reaching consequences of a common currency on all aspects of Community activities. The French economist Rueff, has said: 'L'Europe se fera par la monnaie.'⁽¹⁾

(3) Definition of economic integration

From the point of view of terminology, there are differences of opinion as to the exact meaning of economic integration, and this has caused a certain ambiguity in discussions on the subject.

Balassa defines economic integration as a process and as a state of affairs.

'Regarded as a process, it encompasses measures designed to abolish discrimination between economic units belonging to different national states; viewed as a state of affairs, it can be represented by the absence of various forms of discrimination between national economies.'⁽²⁾

Balassa further differentiates between economic union and total economic integration, where the former combines suppression of restrictions on factor movements and some degree of harmonization of national policies, whilst the latter is the unification of policies and requires a supranational authority whose decisions bind member states. This implies that other forms of integration do not need supranationalism, but even a customs union may decide to set up a council to decide on customs matters, and to give it supranational powers.

(1) "Europe will be united through currency".

(2) Bela Balassa, The theory of economic integration, ... p.1.

Pinder adopts the narrower definition of economic integration as being the process of reaching the state of union, and 'economic union as a state in which discrimination has been largely removed, and co-ordinated and common policies have been and are being applied on a sufficient scale.'⁽¹⁾

Pinder's terminology appears to clarify the problem but it does not help define the state of affairs which exists when countries begin the process of economic integration. Thus we must go back to Balassa's definition of economic integration as a process and a state of affairs and apply this formula to free trade areas, economic unions and other types of integration. There are two elements in integration: the process, which begins with a declaration of intention by the countries concerned, and the state of affairs which is the result of measures taken to carry out these intentions. The Stockholm Convention of 1960 established the European Free Trade Association by announcing the intention of the 'Seven' to establish a free trade area, although the tariff barriers were not eliminated until several years later. The Benelux countries were regarded as an economic union long before the final treaty of 1958 which put the finishing touches on various measures taken by Belgium, the Netherlands and Luxembourg from 1944 onwards.

The intention of the signatories of the Treaty of Rome of 1957 was undoubtedly to form an economic union, even though a full customs union was not achieved until July 1968 and it will be many years before there is complete economic integration between the members. Moreover, there may always be some sector of the economy which evades the application of common policies.

(1) G.R. Denton, (ed.), Economic integration in Europe, (John Pinder, Problems of European integration).....p. 145.

Economic integration differs from economic co-operation in several respects. Economic co-operation such as is carried out under the auspices of the General Agreement on Tariffs and Trade aims at reducing discrimination and barriers to trade between countries by encouraging non-discriminatory policies and the lowering of tariffs. With economic integration, there is to be complete suppression of discriminatory rules as well as the formation and application of common policies in a much wider area of economic activities. Another difference between co-operation and integration and one which gives rise to conflict in international relations, is that co-operation tends to take place on a global scale whereas integration is only practicable on a regional scale. Economic integration is often referred to as 'regional integration' to emphasize this aspect.

Economic integration implies the removal of barriers within a group of countries. This is a move towards free trade. At the same time, as it is only within the group that restrictive measures are abolished, those outside the area feel discriminated against and look upon the integration process as preferential arrangements from which they are excluded. Thus integration is a combination of free trade and discrimination. It is this dual aspect which gives rise to the complexity of customs union theory which will be surveyed in the next chapter.

CHAPTER II

CUSTOMS UNION THEORY

Pure theory of customs union - Viner - Meade -
Lipsey - Johnson - Shibata - extension of the theory -
Mundell - Cooper and Massell - Johnson - Arndt -
Mikesell - discussion.

The establishment of Benelux, followed by the formation of the European Economic Community, has prompted a growing volume of economic theory regarding customs unions. The theory of customs union has been defined as 'that branch of tariff theory which deals with the effects of geographically discriminatory changes in trade barriers'.⁽¹⁾ The pure theory, emanating from the early writers, is concerned mainly with the static effects of a customs union and its impact on production and consumption. More recently, the theory has been extended to other aspects, the dynamic, structural and non-economic factors.

A. PURE THEORY OF CUSTOMS UNIONS

Customs unions had been discussed in earlier writings but it was only in 1950 that the first theoretical analyses of the problem appeared. Jacob Viner is usually remembered as the pioneer of customs union theory, although the writings of

(1) R.G. Lipsey, The theory of customs unions, The Economic Journal, vol. LXX, No.279, September 1960, p. 496.

Maurice Byé and Herbert Giersch appeared at the same time.⁽¹⁾ Byé considered the trade-creation versus trade-diversion aspect, but in a looser framework than Viner, and Giersch tackled the locational aspects of an economic union. Nevertheless, Viner's theory remains the basic work on the theory of customs unions and consequently will be examined in some detail below.

(1) J. Viner

Viner pointed out that customs unions are not necessarily beneficial to the participants.⁽²⁾ After the formation of the union, two changes are likely to occur, trade-diversion and trade-creation, and the overall effect is favourable only if there is more trade-creation than trade-diversion.

Consider three countries A, B and C, and goods X and Y. Good X is produced at low-cost in C and at high-cost in B, while good Y is produced at low-cost in B and at high cost in A. Country A applies non-discriminatory tariffs on all imports. Prior to the formation of the customs union, A imports good X from C and buys good Y from local producers, because, although good Y is produced at lower cost in B, the tariff is such that it would be more expensive to import Y from B.

Countries A and B now enter into a customs union and abolish tariffs between them, but maintain tariffs on imports from C. Given a certain common external tariff and ignoring

(1) Maurice Byé, Unions douanières et données nationales, Economie Appliquée, January/March 1950, pp. 121-158. (The English translation was published in International Economic Papers, No.3, London, Macmillan, 1953, pp. 208-234). Herbert Giersch, Economic union between nations and the location of industries, Review of Economic Studies, 1949-50, vol. XVII(2), No.43, pp. 87-97.

(2) Jacob Viner, The Customs Union Issue, New York, Carnegie Endowment for international peace, 1950.

transport costs, A will then buy good X from B because it is cheaper than the cost of X from C plus tariff. Viner calls this trade-diversion. It is held to be harmful because it diverts trade from low-cost to high-cost producers. On the other hand, A will now also buy good Y from B, because B is a low-cost producer of Y and tariffs no longer protect the high-cost producers in A. This is called trade-creation.

Let us take a numerical example.⁽¹⁾ Three countries A, B and C all produce goods X, Y and Z, but at different costs:

	<u>Country A</u>	<u>B</u>	<u>C</u>
Product X	20 units of value	14	12
Y	17	12	14
Z	10	12	16

From these figures, we can see that the lowest-cost producer of X is C, that of Y is B and Z is produced at lowest-cost in A.

Consider the trade of country A in three cases:

a) free trade, b) a tariff of 50% on all imports, and c) a customs union between A and B, with a common external tariff of 50% on imports from C.

a) Free Trade:

With no tariffs to distort trade, A will buy X from C (at the cost of 12 units), Y from B (12 units) and Z locally since it is cheapest in A (10 units).

1) Adapted from Dennis Swann, The Economics of the Common Market, 2nd Edition, Harmondsworth, Penguin, 1972, pp. 34-36.

b) Tariff of 50% on all imports:

Assuming that cost equals price, the figures have now altered as follows, from country A's point of view:-

	<u>Country A</u>	<u>B</u>	<u>C</u>
Product X	20	14+7 = 21	12+6 = 18
Y	17	12+6 = 18	14+7 = 21
Z	10	12+6 = 18	16+8 = 24

In this case, A will still buy X from C, but will purchase both Y and Z locally since the tariff effectively protects A's production of Y, and Z is produced at lowest-cost in A.

c) Customs union between A and B:

Still considering country A, the resulting costs are now as follows:-

	<u>Country A</u>	<u>B</u>	<u>C</u>
Product X	20	14	18
Y	17	12	21
Z	10	12	24

After the formation of the customs union, therefore, A will purchase X and Y from country B, and buy Z locally.

Analysis: If we compare (b) and (c), that is, the situation before and after customs union (but ignoring the free trade situation for the time being) there has been trade-diversion in the case of product X: before union, A bought X from country C, because even with tariff, it was cheapest there, but after union, A will buy X from partner B, since there is no longer any tariff applied to imports from B, and it is now cheaper than to import X from C and pay the 50% tariff. This is considered 'bad' from

a free trade point of view, because A buys from a high-cost producer (B) instead of a low-cost producer (C).

Trade-creation, on the other hand, has occurred in the case of product Y. Before union, A bought Y locally, but with the elimination of tariffs between A and B due to the formation of the customs union, it now buys it from partner country B. It is a movement from high to low-cost production and therefore considered 'good' by free traders.

In the case of the third product, Z, neither trade-creation nor trade-diversion has occurred, since A is the lowest-cost producer of Z.

The final result will depend on the extent of the trade-diversion and the trade-creation.

Although Viner's model assumes constant costs of production, he goes on to consider whether the customs union will benefit from an increase in output and a decrease in unit costs, that is, he considers briefly the possibility of gain from large-scale production. He expresses some doubts about this, however, as he writes:

'The general rule appears to be that once an industry is large enough to make possible optimum scale - and degree of specialization of production - in plants, further expansion of the industry in a national economy of constant over-all size is bound to be under conditions of increasing unit-costs as output increases, in the absence of new inventions.'⁽¹⁾

He admits that this may not be true in the case of a customs union since this increases the size of the 'national' economy but he

(1) Jacob Viner, The Customs Union Issue, ... p. 47.

stresses that this only holds if the customs union increases the inter-member mobility of factors of production. This is why further integration is necessary to reap the full benefit of customs unions, and therefore common markets and economic unions are more likely to lead to benefits from large-scale production than customs unions (or free trade areas) since economic unions provide for the freedom of movement not only of goods but also of factors of production.

It is relevant to mention here that Viner considered illogical the distinction between 100 per cent preferences, as in a customs union, and 99 per cent preference as in a preferential area, and the assumption that the former is 'good' and the latter is 'bad'. This will be discussed at a later stage (see pages 151-152).

Viner concluded his analysis by pointing out that a customs union is more likely to be a movement towards free trade under certain conditions, the most important of which are as follows:-

a) when the area of the customs union is large (because this increases the scope for internal division of labour),

b) when the common external tariff on imports from non-member countries is lower than the individual tariffs, without customs union,

c) when there is a large degree of competitiveness between member countries with respect to protected industries, before union, (1)

(1) This has since been clarified as to mean 'actually highly competitive but potentially highly complementary' so that there is a larger scope for specialization. (see page 39).

d) when differences in unit-costs of protected goods of the same type, between member countries, are large, since this will increase the possibility of trade-creation.

Viner's final conclusion was that from the viewpoint of the free trader, customs unions are neither good nor bad; it all depends on the circumstances of the case.

Comments.

Before proceeding to the works of Meade, Lipsey and others, the following points may be made.

Although Viner dealt mainly with the effects of customs unions on production and largely ignored consumption, he pointed out that a customs union may improve the terms of trade of the member countries vis-à-vis the rest of the world, and that the bargaining power of the union is likely to increase due to the larger size of the bargaining unit. These are important aspects of customs unions, and it seems therefore inaccurate to say that Viner did not explain why customs unions should be formed at all, as some authors have maintained.⁽¹⁾

Trade-creation is not the sudden appearance of new trade, it is trade-diversion of another kind: local or inter-regional trade is replaced by international trade within the customs union. The beneficial element is the movement from high-cost to low-cost production.

The extent to which trade-creation and trade-diversion will occur depends on differences in costs in the countries concerned and the height of the tariffs before and after union. For instance, low tariffs may result in no change in the pattern of

(1) See P. Robson (ed.), International Economic Integration, Harmondsworth, Penguin, 1972, p. 14; M.B. Krauss, (ed.), The Economics of Integration, London, Allen & Unwin, 1973, p. 13.

trade for some products. Let us go back to the three-country, three-product model of page 28, and consider yet another situation (d) where the tariff imposed by the customs union on goods from C is 10% instead of 50%. The costs will then be as follows:-

	<u>Country A</u>	<u>B</u>	<u>C</u>
Product X	20	14	$12+1,2 = 13,2$
Y	17	12	$14+1,4 = 15,4$
Z	10	12	$16+1,6 = 17,2$

A will now buy X from C, Y from B and Z locally.

If we compare the situation before and after the customs union, i.e. (b) and (d), the customs union has caused no change as far as product X is concerned (that is, no trade-diversion) because the common external tariff is 10% instead of 50%. It has, however, led to trade-creation as regard product Y. The final result is, therefore, positive. With a high tariff, (as in our example, 50%) the customs union could be positive or negative, depending on which effect outweighs the other.

Trade-creation and trade-diversion occur not only with the establishment of customs unions, but also with certain changes in tariffs. Consider (a) and (b) on pages 28-9. Product Y is bought from B under free trade, but it is bought locally when a tariff of 50% is imposed on all imports into A. There has been a kind of trade-diversion, since international trade has been replaced by inter-regional trade, but it could be called trade-suspension, as opposed to trade-creation. It is nevertheless a movement from a lower-cost to a higher-cost source of production,

which defines trade-diversion.

If A moves from (b) to (a), that is, eliminates all tariffs, there will be trade-creation: Y which was purchased locally when a tariff protected the producer in A, will now be bought from B, the lowest-cost source.

Finally, let us compare cases (c) and (d), whereby the customs union lowers the common external tariff from 50% to 10%. Country A bought X from B in the first case, but with a lower tariff, purchases X from C. Trade has been diverted from B to C. Yet it is a movement from a high to a low-cost source of production, which is the essential element of trade-creation. If we go from (d) to (c), the opposite occurs, that is trade is diverted from C to B, but in this case, it is a movement from low to high-cost producer.

We must, therefore, bear in mind that trade-creation and trade-diversion refer to changes in the pattern of trade which may occur with a variety of changes in commercial policies, not only the establishment of customs unions.

(2) J.E. Meade

Meade's major contribution to the theory of customs unions was the introduction of consumption effects and variable costs into the analysis.⁽¹⁾ Considering Viner's interpretation, Meade made the criticism that Viner did not explain how to weigh up the economic gains and losses due to trade-creation and trade-diversion, and he proceeded to measure these, first with constant

(1) J.E. Meade, The Theory of Customs Unions, Amsterdam, North-Holland, 1955.

costs and then with variable costs, taking the Benelux as example.

Three countries, Germany, Belgium and the Netherlands, produce steel at the following costs: Germany, \$100; Belgium, \$150 and the Netherlands, \$250. Let us consider the trade of the Netherlands, before and after a customs union with Belgium, (a) with a tariff of 100%, and (b) with a tariff of 200%.

a) Before customs union with Belgium, the Dutch buyer will have to pay \$200 for German steel, \$300 for Belgian steel and \$250 for locally produced steel, assuming that cost equals price and ignoring transport costs. He will, therefore, buy German steel. After the establishment of a customs union, Belgian steel will then become the cheapest and there will be trade-diversion. This is considered uneconomic and wasteful because it is a switch from the lowest-cost to a higher-cost producer.

b) If the duty is 200%, the costs before union will be: German, \$300, Belgian, \$450 and Dutch steel, \$250 (no duty). The Dutch buyer will buy local steel. After forming a customs union with Belgium, however, he will buy steel from Belgium, at the cost of \$150, and this is trade-creation, because it is a move from a higher-cost domestic to a lower-cost foreign source of production.

We may conclude from these examples, that the effect of the customs union will be either trade-creation or trade-diversion, depending on the height of the tariff, and that a customs union is more likely to raise economic welfare when the initial tariffs removed by integration are high. We have assumed that the tariff applied by the Netherlands was the same as the subsequent common

external tariff of the customs union, but of course, this need not always be the case, it could be higher or lower (although the rules of the GATT forbid an increase in tariffs due to the formation of customs unions).

Meade then asks how one may calculate the economic gains and losses from a customs union, which Viner did not elaborate upon.

One may calculate the value of trade diverted and the value of trade created and subtract one from the other. For example, suppose that \$100 million worth of trade in steel was diverted from low-cost Germany to high-cost Belgium, and \$30 million worth of trade in cheese has been created between low-cost Netherlands and high-cost Belgium. One could subtract one from the other and conclude that the net diversion amounts to \$70 millions.

Meade then assumes different unit costs: the cost of a unit of Belgian steel is 50% higher than German steel, and the cost of a unit of Belgian cheese is 200% higher than Dutch cheese. Then, trade-diversion is 50% of \$100 million = \$50 million and trade-creation is 200% of \$30 million = \$60 million. In this case, there is a net gain. It is more accurate to multiply each element of diverted trade by the rise in unit cost of that trade, similarly to multiply the value of each element of created trade by the fall in unit-cost of that trade, and subtract one from the other.

Meade goes on to point out that this procedure is only suitable when the elasticity of demand is nil and the elasticity of supply is infinity. We shall confine ourselves to an examination of the elasticity of demand.

Consider the above-mentioned diversion of Dutch imports of steel from low-cost Germany to high-cost Belgium when the

Netherlands and Belgium form a customs union. If the demand for steel in the Netherlands is fixed, then the only question is where and at what cost this steel will be produced. Also, if the cost of producing steel is constant regardless of the amount produced, then this fixed amount of steel will be produced at one place, at one definite and constant cost of production.

In the first example, suppose that the Netherlands have a fixed demand for 1 million tons of steel. Before union, they buy this from Germany at a price of $\$100 + \$100 = \$200$ per ton. After union, they will buy it from Belgium at $\$150$ per ton. Therefore, the demand of 1 million tons costs $\$150$ million.

This is now complicated if the demand and costs of production are not fixed. Suppose that the demand for steel, instead of being fixed, depends on the price of steel in the Netherlands. Suppose that, as illustrated in Figure 5, at the price of $\$200$ per ton, demand is 1 million tons, but if the price drops to $\$150$ per ton (as it would after customs union with Belgium), then demand increases to 3 million.

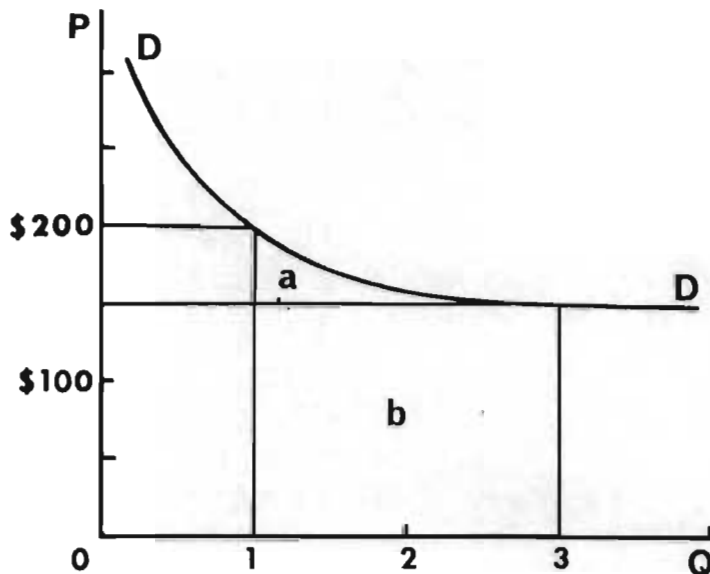


Figure 5: Changes in Demand

Then, instead of importing 1 million tons of steel costing $\text{£}200$ per ton, the Netherlands now import 3 million tons of steel costing $\text{£}150$ per ton. Meade questions whether, being trade-diversion, this is necessarily a change for the worse. To answer this question, one would have to consider the value of this steel to the Netherlands, its cost of production in Belgium, the satisfaction of consumers, etc.

We should now also consider the value of the additional 2 million tons of steel to the Dutch buyer:-

The cost of the 2 extra million tons, bought from Belgium, is $\text{£}150 \times 2 = \text{£}300$ million. The value of 1 ton of steel in the Netherlands was $\text{£}200$ before customs union, but $\text{£}150$ after union. The value of 2 million extra tons of steel is therefore between $\text{£}400$ million ($2 \text{ million} \times \text{£}200$) and $\text{£}300$ million ($2 \text{ million} \times \text{£}150$), i.e. area a + b in Figure 5. Let us say it is worth $\text{£}350$ million to the Dutch consumers. But it has cost Belgian producers $\text{£}300$ million to produce (since the unit-cost is $\text{£}150$). Therefore, there is a gain of $\text{£}50$ million of consumers' value over producers' costs which offsets the loss of $\text{£}50$ million on the trade-diversion, which gain, writes Meade, is overlooked by Viner.

Meade concludes that:

'A reduction in the import duty levied on the exports of a partner country may totally divert existing trade from a cheaper outside source; but as it will reduce the market price of the product inside the importing partner country, there will be an expansion of the total imports of that country. And in so far as the initial price (including tax) in the importing country exceeded the cost of production in the partner country which provides the

additional supplies, there is some economic gain to be set against the extra cost of production on the diverted trade.'⁽¹⁾

The same analysis could be carried out with regard to trade-creation, and results from both trade-creation and diversion may be considered under conditions of inelastic supply.

Meade proposes that a customs union is likely to be beneficial under the following conditions:-

a) If the economies of the partner countries are actually very competitive but potentially very complementary. This requires some explanation: consider two countries, both producing X and Y, although country A is better suited to the production of X and B to the production of Y. Under protection, however, A will produce Y at high-cost and B will produce X at high-cost. Their economies are competitive and similar. If they form a customs union, they may now specialise in the product they are best suited to produce, thus A will concentrate on the production of X and B on the production of Y, and their economies will become complementary.

b) If the initial rates of duty on imports are high, since their removal is bound to cause some expansion of their trade.

c) If each member is the principal supplier to the other of the products which it exports to the other country, and similarly, if each member is the principal market for the other of the products which it buys from the partner country.

d) If the proportion of the world's production, consumption and trade which is covered by the customs union is large.

(1) J.E. Meade, The Theory of Customs Unions, 1955, p. 40.

Meade adds a few other conditions which are not essential to our present purpose.

Similarly to Viner, Meade concludes that one cannot generalise on customs unions, because it all depends on the circumstances of the case. Unlike Viner, however, Meade does take position in favour of customs unions

'... one can, I think, start with some general prejudice in favour of a customs union. It represents a reduction in trade barriers which will lead in all cases to some primary expansion of trade, and on this expansion of trade there will almost always be some important gain.'⁽¹⁾

3) R.G. Lipsey

Viner's analysis assumed that goods were consumed in fixed proportions. This assumption was relaxed by Lipsey in 1957,⁽²⁾ by introducing the effects of substitution between commodities resulting from changes in prices, and using commodity indifference curves. He demonstrated that the welfare of a country may be improved by forming a trade-diverting customs union, if a positive consumption effect outweighs a negative production effect.

Lipsey's model consists of three countries A, B and C and two products wheat and clothing. Country A consumes wheat and clothing; wheat is produced locally and clothing is imported from C, the lowest-cost producer.

The trade of country A is considered in three cases: free trade, a tariff on imports of clothing from C, and finally, a customs union between A and B.

(1) J.E. Meade, The Theory of Customs Unions, 1955, p. 107.

(2) R.G. Lipsey, The theory of customs unions: Trade diversion and welfare, Economica, vol. 24, 1957, pp. 40-46.

a) Free Trade

A buys clothing from C since it is produced at lower cost than in B. In Figure 6, DE illustrates the given terms of trade between A and C. Curve I is an indifference curve of A, assuming there is only one consumer in A. Therefore, every point on I represents a different combination of wheat and clothing, all of which give equal satisfaction to A. The free trade position of equilibrium is at G, where I is tangential to DE, because it is only at that point that the slope of DE equals that of I.

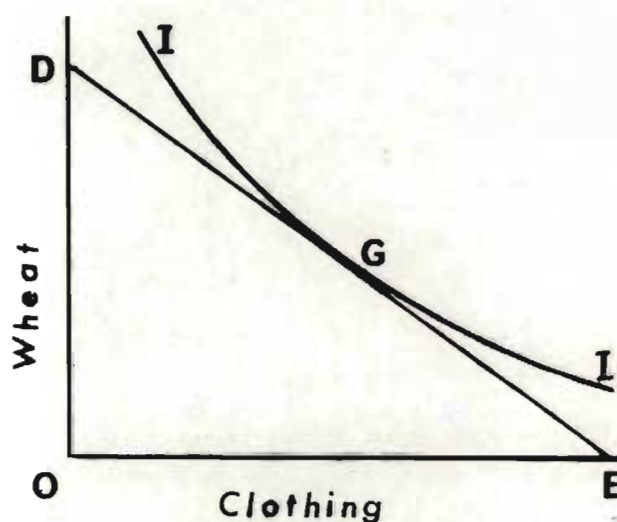


Figure 6: Free Trade

b) Tariff on imports of clothing

Now assume that A levies a tariff on clothing imports from both B and C. A will continue to buy from C, assuming that the tariff is not prohibitive, but merely raises the price of imports. The new terms of trade are shown by DF in Figure 7. If the tariff revenue is lost to A, the new equilibrium is at H, where a lower indifference curve I' is tangential to DF.

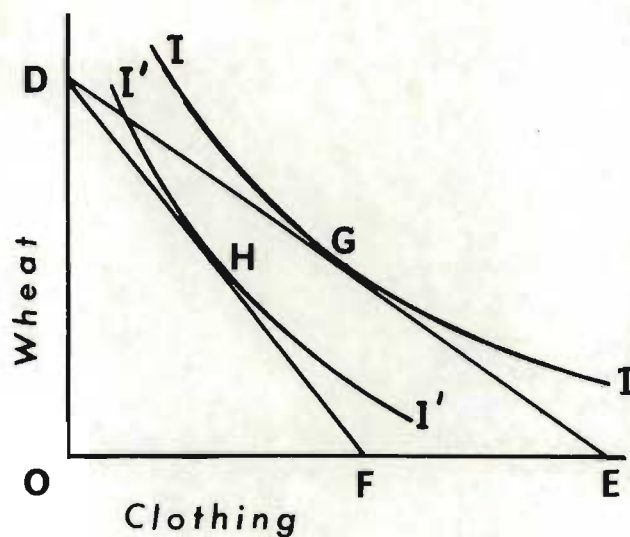


Figure 7: Tariff on Imports

But if one assumes that the tariff revenue is in fact redistributed to the consumer (in the form of lower taxation or by some other means), then Lipsey points out that the equilibrium point will be on DE, that is, on the same income-consumption line as before tariff. This is shown in Figure 8, from which it is evident that the new equilibrium point will be at K, where an indifference curve I'' has the same slope as the new terms-of-trade line DF.

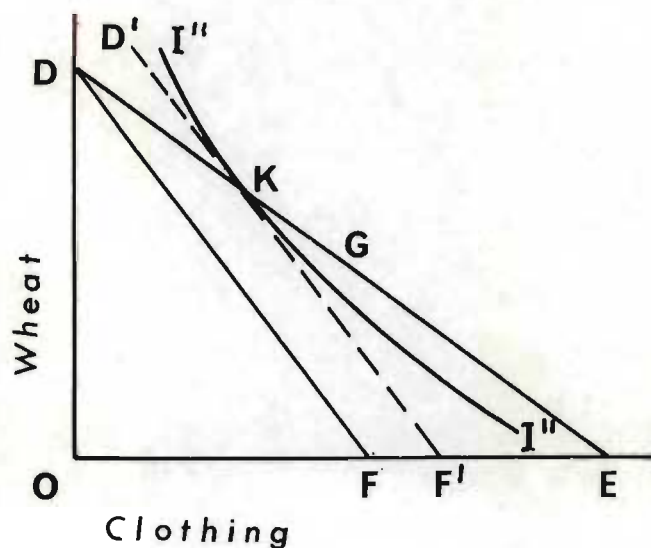


Figure 8: Redistribution of Tariff Revenue

It should be noted that this point K is arrived at by drawing $D'F'$ parallel to DF , in such a way that $D'F'$ becomes tangential to an indifference curve of A and cuts DE at the same time. At that point, it is impossible for A both to trade along $D'F'$ and also to reach a higher indifference curve. Comparing the two equilibrium positions, G before tariff and K after tariff (assuming a redistribution of tariff revenue), the tariff has the effect of reducing imports of clothing and increasing consumption of wheat.

c) Customs Union between A and B

Lipsey then assumes that A forms a trade-diverting customs union with B. Without tariff, the price of C's clothing is lower than B's, but with tariffs imposed on imports from C, the price of C's clothing plus tariff is higher than the price of B's clothing without tariff. Therefore, the terms of trade between A and B must lie somewhere between DE and DF .

This is illustrated by Figure 9, by drawing from D a tangent to the indifference curve I'' and extending it to cut OE at V.

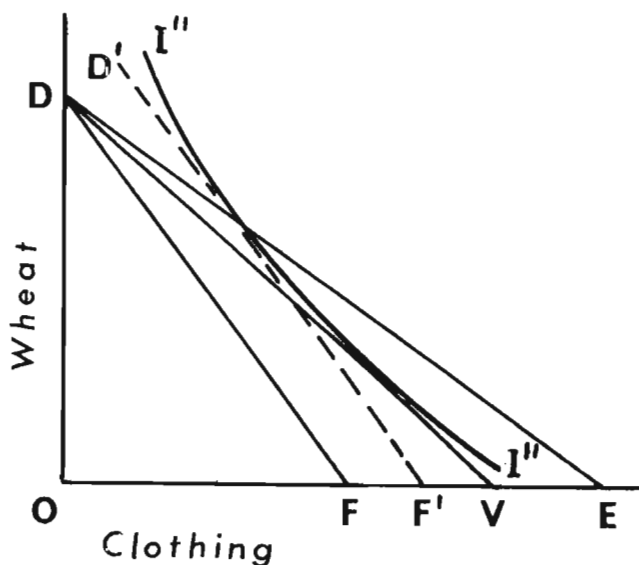


Figure 9: Terms of Trade in Customs Union

The slope of this line DV indicates the terms of trade between countries A and B (in a custom union) which leave A as well off as when trade was with country C (with tariffs), since both D'F' and DV are tangential to indifference curve I". If A obtains terms of trade with B which are worse than DE but better than DV, then the customs union will increase A's welfare, even though it is trade-diverting. This is because a terms-of-trade line between DE and DV would be tangential to a higher indifference curve. If on the other hand, the terms of trade are better than DF but worse than DV, there will be a loss of welfare for A because the terms of trade line would then become tangential to a lower indifference curve. Therefore, as long as the final equilibrium point is in the area above I", but below DE, trade carried on with B (at terms of trade worse than those shown by DE) will increase A's welfare. Thus Lipsey concludes that A might gain by entering into a custom union with B, even if this causes trade-diversion from lower to higher cost sources of supply, and he also shows that even world welfare may be increased by the same process.

Criticisms of Lipsey's analysis by Cooper and Massell and also by Krauss, will be examined below (see pages 52 and 57).

4) H.G. Johnson

Johnson's 'Economic theory of customs union' is examined here because of the clarity of his analysis of trade-creation and trade-diversion.⁽¹⁾

He begins by stressing the complex nature of customs union theory by pointing out that:

(1) H.G. Johnson, The economic theory of customs union, Pakistan Economic Journal, vol. X, No.1, March 1960, pp. 14-32. Reprinted in H.G. Johnson, Money, Trade and Economic Growth, London, Allen & Unwin, 1962, Chapter III.

'the fact that a customs union is a mixture of freer trade and more protection means that it cannot be analyzed by established welfare economics theory, which is concerned with the conditions for maximum welfare - the optimum conditions.'⁽¹⁾

The theory of customs union tries to deal with the conditions for improving welfare and not for achieving maximum welfare. It is in fact an application of the 'theory of second-best' which can be stated as follows:

'If in an economy all the optimum conditions for welfare maximisation are not fulfilled simultaneously, then a change which increases the number of conditions fulfilled does not necessarily increase the welfare of that economy. The effect on welfare of fulfilling one more condition will depend on the circumstances of each case.'⁽²⁾

A customs union, writes Johnson, will cause an increase in the demand for imports for two reasons; (a) replacement of domestic production by partner production of the same good (production effect) and (b) increased consumption of partner goods in general, due to lower prices of imports substituting for domestic goods (consumption effect). Both the production and the consumption effects constitute trade-creation.⁽³⁾

In Figure 10, DD and SS represent the domestic demand and supply curves for a commodity. PQR is the partner supply curve, assumed to be constant-cost. If PP' is the tariff imposed on imports from the partner before customs union, then P'Q'R' will be the

(1) H.G. Johnson, Money, Trade and Economic Growth, p.47.

(2) David Young, International Economics, 2nd Edition, London, Intertext Books, 1972, p. 88.

(3) Some authors consider only the production effect as constituting trade-creation, and refer to the consumption effect as being 'positive'.

partner supply curve with tariff.

Before customs union, OB' is consumed (OT' is locally produced, $T'B'$ is imported from partner). After customs union, consumption increases to OB (OT is from local production, TB is imported).

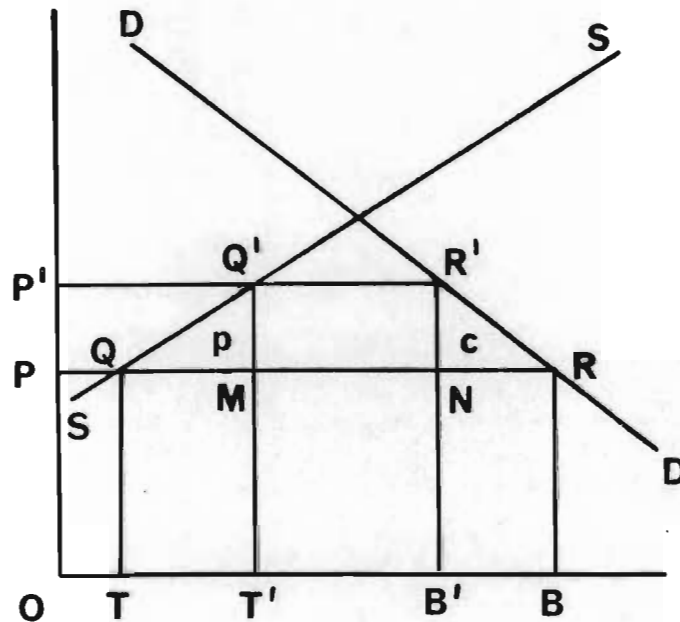


Figure 10: Trade Creation

The saving of cost on domestic production replaced by imports is illustrated by the triangle $QQ'M$, and the gain in consumers' surplus from the substitution of imports for other goods previously domestically produced is the triangle $R'NR$. If we call those two areas p and c (production effect and consumption effect) the total trade-creation effect is $p + c$ which is $= \frac{1}{2}(TT' + B'B)PP'$. Considering the remaining two areas, $P'Q'QP$ is the transfer of producers' surplus to consumers and $Q'R'NM$ is the transfer of tariff proceeds to consumers ('loss of revenue').

Trade-diversion is a shift in source of imports from lower-cost foreign source to higher-cost partner source. In

Figure 11, DD is the domestic curve, FTM and F'Q' are the constant-cost supply curves of the foreign source before and after tariff, whilst PRQ and P'Q'' are the constant-cost supply curves of the partner source, before and after tariff respectively.

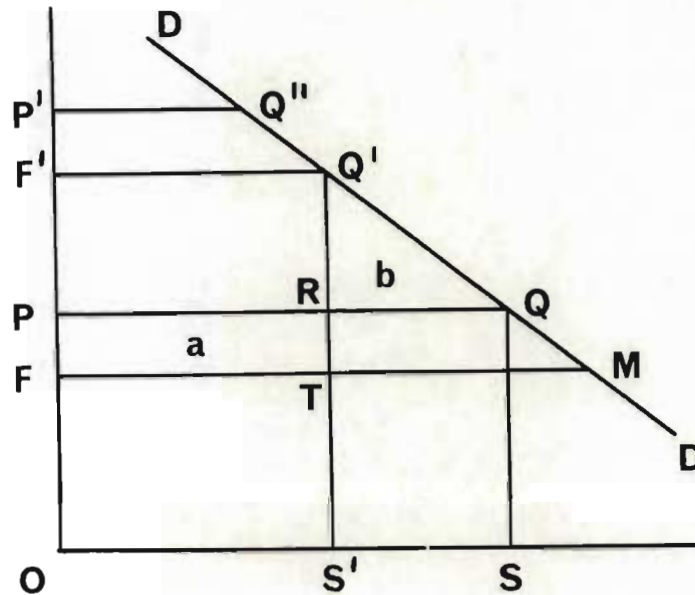


Figure 11: Trade Diversion

When a tariff is applied to both foreign and partner imports, the domestic country imports OS' from the foreign country, which is lower-cost, the total cost being the area OFTS', since it is assumed that the tariff revenue FF'Q'T is a transfer rather than a cost or a gain. When the customs union is formed and the tariff on the partner country's imports is eliminated, the country will import OS from its partner, at a total cost of OPQS. For its previous consumption, OS', it now pays OPRS', which is an increase of FPRT (area a) over the previous cost. This is the loss due to trade-diversion, and it must be weighed against the trade-creation gain Q'QR, the consumption effect (area b).

In his theory of customs union, Johnson further points out that if the assumption of perfectly elastic supply of foreign and partner's goods is relaxed, and we consider increasing costs of supply, then the following occurs: (a) the foreign supply price will fall as trade is diverted from foreign to partner country, therefore, the home country will enjoy improved terms of trade with the foreign country, and this will reduce the loss due to trade-diversion; (b) the partner supply price, on the other hand, will increase as trade is diverted and the loss to the country per unit of trade diverted is greater than it would have been with constant costs. However, part of this loss is a transfer from domestic consumers' surplus to partner producers' surplus and therefore not a net loss to the customs union as a whole.

In a later work, Johnson considers the non-economic factors in the formation of customs unions.⁽¹⁾ This will be examined in the extension of the theory, below.

5) H. Shibata

Before ending this survey of the pure theory of customs unions, mention must be made of Shibata's theory of a free trade area.⁽²⁾

The theories considered so far have been concerned exclusively with customs unions. However, other forms of economic integration are possible, and among these, the free trade area is the most commonly found today, the best example being that of the European Free Trade Association, of which Britain was a member until joining the EEC.

(1) H.G. Johnson, An economic theory of protectionism, tariff bargaining, and the formation of customs union, Journal of Political Economy, vol. 73, 1965, pp. 256-283.

(2) P. Robson (ed.), International Economic Integration, (H. Shibata, A theory of free trade areas), Harmondsworth, Penguin, 1972, pp. 68-87.

The free trade area differs from the customs union in that each member country retains its own tariff vis-à-vis outside countries, and therefore, there is no common external tariff. The member countries are less integrated than in customs unions. The main problem of free trade areas is 'trade deflection' defined as 'the redirection of imports from third countries through the partner country with the lowest tariff, with the aim of realizing tax advantage by exploiting the rate differentials between the member countries...' (1) For example, suppose country A has formed a free trade area with countries B and C, their respective tariff against imports from outsider country X being 30%, 20% and 10%. Instead of importing a product from X directly into A and paying a 30% tariff, there may be 'trade deflection', that is, the product might be imported into C and pay only 10%. From C to A there is no tariff barrier by definition and therefore, there is no further tax to pay. Trade from X to A has been 'deflected' through the lowest-tariff country C. To avoid this trade deflection, free trade areas have to evolve rules of origin, which may be complicated by the fact that some imports are raw materials, processed in one country and sold in another, or semi-processed goods, re-exported as finished goods in another member of the free trade area.

The similarity between customs unions and free trade areas lies in the fact that in both cases there is an element of free trade between partners and of discrimination against outsiders. Shibata shows that a free trade area is comparable to a customs union which adopts a common external tariff higher than the lowest tariffs which existed among members before union. It is difficult to decide

(1) P. Robson (ed.) International Economic Integration, (H. Shibata)...
p. 69.

which of the forms of integration is the best, because the effects of both customs unions and free trade areas

'depend on a large number of unknown parameters and variables involved in a large number of demand and supply schedules of the commodities thus affected.'⁽¹⁾

However, when some economic characteristics are known for each prospective member of the groups, the following predictions may be made:-

a) A country which is highly specialized and is likely to have a number of very low duty items will prefer to join a free trade area, whereas a diversified-economy country will be more likely to have a number of protective tariffs and will therefore tend to form a customs union.

b) Countries whose economies are complementary will tend to form a free trade area, and those whose economies are competitive will form a customs union.

c) In a free trade area between a country with large productive capacity and one with a small productive capacity, both protected by tariffs, the small country may try and influence the larger one to maintain its margin of preference vis-à-vis products of the smaller country. That is, one country should not reduce its tariff on imports from outside countries without consultation with the members of the free trade area. This may be difficult to achieve, since the terms of a free trade area are usually strictly defined to mean elimination of duties between members, while maintaining freedom of action in other aspects of trade policy.

In the same way as Viner, who concluded that customs

(1) P. Robson, International Economic Integration, (H. Shibata), p. 83.

unions are neither necessarily good nor necessarily bad, Shibata's theory does not put forward a case for free trade areas as being more likely to promote welfare than customs unions.

B. THE EXTENSION OF THE THEORY

The pure theory of customs union remains inconclusive, since it fails to prove that customs unions are either beneficial or harmful to the members of the union or to the world as a whole. Consequently, recent writings have extended the theory into new fields of research.

'Since Lipsey's critically significant 1960 survey paper, the theory of customs unions has been refined, extended and re-interpreted with a major change in theoretical orientation away from the question of the economic effects of customs unions to the more fundamental one of why they are formed in the first instance.'⁽¹⁾

Whereas the basic theory focussed on production and consumption effects, the new areas of study include terms of trade effects, comparison of preferential and non-preferential systems of tariff protection, non-economic factors, dynamic or structural aspects, and integration among developing countries.

1) R.A. Mundell (1964)

Among contributors to the extension of the theory, Mundell concentrates on the terms of trade effects of customs unions.⁽²⁾ One of the important propositions which emerge from

(1) Melvyn B. Krauss, Recent developments in customs union theory: an interpretive survey, Journal of Economic Literature, vol. X, No. 2, June 1972, p. 413.

(2) R.A. Mundell, Tariff preferences and the terms of trade, Manchester School of Economic and Social Studies, vol. 32, 1964, pp. 1-13; reprinted in P. Robson (ed.) International Economic Integration, Harmondsworth, Penguin, 1972, pp. 143-155.

his study is that there exists a presumption that the terms of trade of members of the customs union will improve relative to the outside world. This is established by the fact that the balance of trade of the union as a whole must improve, while that of each country in the rest of the world must deteriorate. This factor usually leads outside countries to take actions such as demands for compensation or the formation of other forms of economic integration (for instance, the formation of EFTA following the establishment of the EEC).

2) C.A. Cooper and B.F. Massell (1965)

These authors argue⁽¹⁾ that since a non-preferential tariff policy can be shown to be superior to customs unions as a trade-liberalizing device, the reason behind the formation of such unions could not be a better allocation of resources, as was widely believed.

Cooper and Massell question the value of Viner's analysis as a basis for evaluating customs unions, since it fails to show why customs unions are formed. They also criticize Lipsey's assumption that the tariff revenue collected by the government is returned to consumers, because they feel that the harmful effects of finding other sources of revenue must be taken into account. Cooper and Massell demonstrate that the effect of a customs union is made up of two components, a tariff reduction component and a pure trade diversion component. The former is the sole source of gain in consumers welfare, accounting for both the production and the consumption effect of trade-creation. Furthermore, they maintain

(1) C.A. Cooper and B.F. Massell, A new look at customs union theory, Economic Journal, vol. 75, 1965, pp. 742-747.

that compared with an appropriate policy of non-preferential protection, a customs union results in pure trade-diversion and is therefore inferior. They conclude that the theory of second-best is not helpful in evaluating the welfare effects of the customs union per se; second-best theory is relevant only for evaluating the welfare effect of the tariff reduction component. Consequently, they consider that the basic theory has neglected other potential sources of gain of customs unions, such as improvements in terms of trade, dynamic effects, economies of scale, more efficient technology and the public good argument for protection.

3) H.G. Johnson (1965)

In the same year, Johnson outlines a theory which attempts to explain the nature of tariff bargaining and the commercial policies adopted by countries.⁽¹⁾ He assumes that governments seek to maximize the satisfaction enjoyed by the electorate. This satisfaction, he points out, comes not only from private consumption of goods and services but also from collective consumption provided through the government at the cost of sacrifices of private consumption, which was generally ignored by traditional theory. Johnson further assumed that there exists a collective preference for industrial production, due to factors such as national prestige or pressure groups, leading to the dominance of producer interests.

Johnson writes:

'... contrary to the standard analysis trade-diversion as well as trade-creation yields a gain to the partners;

(1) H.G. Johnson, An economic theory of protectionism, tariff bargaining, and the formation of customs unions, Journal of Political Economy, vol. 73, 1965, pp. 256-283; reprinted in P. Robson (ed.) International Economic Integration, Harmondsworth, Penguin, 1972, pp. 99-142.

in fact, trade-diversion is preferable to trade-creation, for the preference-granting country, because it entails no sacrifice of domestic industrial production. This reversal of the usual conclusions is due to the presence of the preferences for industrial production ...'(1)

Thus, he brings a new dimension to the theory by accepting the relevance of non-economic objectives in governments' trade policies.

4) S.W. Arndt (1968 and 1969)

In two recent articles, Arndt considers the terms-of-trade effects of customs unions.^{(2) (3)} Commenting on Cooper and Massell's analysis, Arndt points out that their conclusions depend upon the assumption that the customs union is small and therefore incapable of influencing the terms of trade.⁽²⁾ He stresses as possible gains of a customs union, improved terms of trade and improved bargaining power, because the terms-of-trade effect of the customs union may be sufficient to lead to a net improvement in welfare over a non-preferential tariff situation, and the combined economic power of members of the union acting as one may accomplish what one country alone might be unable to do. Arndt concludes that considering the alternative solutions which must include the pooling of economic power and reciprocal advantages ('some form of international collusion') the customs union may be the most workable of these arrangements.

(1) P. Robson (ed.), International Economic Integration, (H.G. Johnson, Economic theory of protectionism...), p. 131.

(2) S.W. Arndt, On discriminatory versus non-preferential tariff policies, Economic Journal, vol. 78, December 1968, pp. 971-979.

(3) S.W. Arndt, Customs union and the theory of tariffs, American Economic Review, vol. 59, No.1, March 1969, pp. 108-118.

In the second article,⁽¹⁾ Arndt criticizes the three-country models used by earlier economists, which assume that the outside world is made up of one homogeneous unit, because in fact, it is composed of a large number of heterogeneous countries with various tariffs and trade policies. His conclusions include the following important points: (a) it is no longer particularly meaningful to argue that the customs union will do one thing or another to the terms of trade of other countries, since changes will cause gains for some and losses for others; (b) it may be rational for a country to press for the formation of a customs union yet remain outside, if the union increases the share of the market of the outside country; (c) compared to other types of tariff policies, customs unions may be superior to non-preferential tariff policy.

5) R.F. Mikesell (1963)

Finally, the theory of customs unions has been extended into the special problem of their applicability to developing countries, and an important contribution to this aspect was made by Mikesell.⁽²⁾ He begins by stressing the point that the gains from customs unions are more likely to spring from the dynamic than the static effects:

'I doubt ... if the most significant gains from the creation of the European Economic Community are to be

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- (1) S.W. Arndt, Customs Union and the theory of tariffs, American Economic Review, vol. 59, No.1, March 1969, pp. 108-118.
- (2) R.F. Mikesell, The theory of common markets as applied to regional arrangements among developing countries, Chapter 9, in R.F. Harrod and D.C. Hague (eds.) International Trade Theory in a Developing World, Macmillan, 1963, pp. 205-229. Reprinted in P. Robson (ed.), International Economic Integration, Harmondsworth, Penguin, 1972, pp. 166-194.

discovered through a comparison of trade-diverting and trade-creating effects on welfare, even if we could measure them.'⁽¹⁾

The important effects of customs unions, Mikesell maintains, will be those resulting from the broadening of the market, creating opportunities for innovations and changes in investment patterns. In other words, the dynamic effects, which because of their intangibility, 'often lie outside the economist's analytical framework'.⁽²⁾ Mikesell suggests that the analysis should be concerned with the effects on investments in developing countries, which will determine trade and production patterns in the long-run. He also questions the applicability of the generalizations of the theory which relate to the complementary, competitiveness and trade patterns of the members, to developing countries. He concludes that the main problem for these countries is the inability to specialise and that regional trading arrangements such as customs unions may provide an opportunity for specialisation and increased trade, for broadening the export base of single countries and increasing the productivity of the region as a whole.

C. DISCUSSION

There is no consensus of opinion in customs union theory, except as regards its complexity. The simplicity of Viner's analysis led to criticisms as to its usefulness. On the other hand, in a valuable survey of customs union theories,⁽³⁾ Krauss criticises

(1) P. Robson, (ed.) International Economic Integration, (R.F. Mikesell), p. 166.

(2) P. Robson, (ed.) op. cit., p. 167.

(3) Melvyn B. Krauss, Recent developments in customs union theory: an interpretive survey, Journal of Economic Literature, vol. X, No. 2, June 1972, pp. 413-436.

Lipsey's analysis of the trade-diverting customs union for two reasons: (a) by proving exceptions to Viner's 'law' of customs unions, Lipsey implies that Viner's purpose was to formulate such a law and that such a formulation represents an acceptable analytical procedure. 'Both implications are controversial at best'.⁽¹⁾ (b) when Viner's assumptions are not used, it is meaningless to use the term 'trade-diverting' customs union.

Krauss doubts the dynamic effects of customs unions and economies of scale, as well as the 'public good' argument in favour of unions, and he concludes that 'customs unions are best conceived as non-economic institutions'.⁽²⁾ This is an oversimplification. Integration between countries is a complex process which affects the economic, political and social domains of the member countries and therefore, preferential arrangements such as customs unions and economic unions have both an economic and political content.

It has been said that, as traditional trade theory fails to explain why policies other than free trade are followed by governments, in the same way, the theory of customs unions has so far failed to explain why such unions occur, and that consequently, the theory has moved away from the question of whether customs are 'good' or 'bad' to the problem of the motivation for these arrangements. In fact, economists continue to analyse the effects of customs unions - and thereby, explain the reasons for their formation - but whereas the basic theory was confined to production

(1) Melvyn B. Krauss, Recent developments in customs union theory: an interpretive survey, Journal of Economic Literature, vol. X, No.2, June 1972, p. 417.

(2) Melvyn B. Krauss, op. cit., p. 430.

and consumption effects (the static effects), the extension of the theory is probing the terms of trade and dynamic effects as well as non-economic factors. Countries form customs unions and economic unions because they anticipate a number of economic and political gains. If the theory of customs union has so far been unable to determine the nature of the economic benefits, it is because wide areas have not been investigated and some of them may defy all conclusive empirical research. If any conclusion may be drawn from the extension of the theory, it is that the dynamic effects and the non-economic factors are, in the long-run, more important to the countries involved, than the static effects of customs unions.

There is some controversy in current customs union literature as to the nature of the dynamic effects, mainly because they have not been clearly defined. Some writers, notably Krauss, maintain that the term is a misnomer since these effects are susceptible to orthodox static analysis.⁽¹⁾ On the other hand, Balassa and Mikesell support the view that the term 'dynamic effects' refers to changes in the basic structure of the economy, such as the effects of a larger market on various factors which are assumed in static analysis (for example, technology, efficiency of factors of production, internal and external economies of scale). It is evident that most of these effects are difficult to assess with present tools of economic analysis, but nevertheless they form an integral part of the consequences of customs unions and it is therefore difficult to agree with Krauss. We shall go further and extend the term dynamic effects to include the impact of economic integration on trade patterns and trade policies of countries outside the customs union.

(1) Melvyn B. Krauss, Recent developments in customs union theory, Journal of Economic Literature, vol. X, No.2, June 1972, p.419.

The term 'non-economic' is also undefined. Some well-known effects such as increased bargaining strength of countries linked in customs unions, is regarded by some writers as economic and by others, as non-economic.

Quantitative estimates of the gains from economic integration have been carried out, notably those of Verdoorn, Johnson, and more recently, Balassa, but they all give negligible results. Verdoorn's calculations of the gains from freer trade yielded a figure of 0,05 per cent of national income⁽¹⁾ and Johnson arrived at a maximum figure of 1,0 per cent of national income.⁽²⁾ Balassa calculated that between the periods 1953-59 and 1959-65 the income elasticity of demand in the EEC increased from 1,8 to 2,1 with respect to total (intra- and extra-area) imports.⁽³⁾ This adds weight to the recent trend of thought that the static effects are less important than the dynamic effects of customs unions and that non-economic factors must be kept in mind in any assessment of economic integration.

Comparing free trade areas with customs unions, it has been pointed out that Shibata's theory does not conclude that the former are more beneficial than the latter. Yet the view has been put forward that:

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- (1) Verdoorn, unpublished thesis, quoted and used by T. Scitovsky, Economic Theory and Western European Integration, Allen and Unwin, 1958, pp. 64-78.
- (2) H.G. Johnson, The gains from free trade with Europe: an estimate, Manchester School, vol. XXVI, September 1958. (For fuller details of the Verdoorn and Johnson estimates, see R.G. Lipsey, The theory of customs unions: a general survey. The Economic Journal, vol. LXX, No.279, September 1960, pp. 509-511.
- (3) Bela Balassa, Trade-creation and trade-diversion in the European Common Market, The Economic Journal, vol. 77, 1967, pp. 1-21.

'...with the exception of countries with widely divergent tariff structures, free trade associations are a more efficient way of promoting economic integration than customs unions.' (1)

This statement appears to be a contradiction in terms, since countries in free trade areas are, by definition, less integrated than if they form a customs union.

In view of the inconclusiveness of customs union theory, one may wonder along what lines further developments will take place. John Pinder wrote:

'... customs unions tend to be set up for 'political' reasons rather than because of econometricians' forecasts of changes in trade, from which it follows that economic analysis would be more fruitfully focused on the implications for economic policy of the existence of customs unions than on the justification of customs unions in terms of forecast changes in the flow of trade.' (2)

Krauss questions the role of economic research 'when it is accepted that the objective of governmental policy is non-economic in nature'. (3) Either an attempt is made to develop analyses whose purpose is to achieve the non-economic objective at minimum cost to the community, or an effort is made to find out whether the non-economic benefits are worth the net economic

(1) Victoria Curzon, 'The Essentials of Economic Integration', Lessons of EFTA Experience, London, Macmillan, 1974. (Harry G. Johnson, Introduction), p. 2.

(2) G.R. Denton (ed.), Economic Integration in Europe, (John Pinder, Problems of European integration), London, Weidenfeld and Nicolson, 1969, p. 148.

(3) Melwyn B. Krauss (ed.), The Economics of Integration, London, Allen and Unwin, 1973, p. 16.

costs. Krauss supports the second method.

Little has been said of the effects of customs unions on other countries except for the tentative assumption that they are bound to lose as the result of discrimination. Their terms of trade with the customs union may deteriorate, but they may benefit in other ways. For example, the growth of the economies of the Common Market countries resulted in an increase in trade with third countries. It is possible that this might have happened in any case. Nevertheless, there is no proof of injury to outside countries. The principle that compensation must be given to countries who are adversely affected by certain arrangements (such as customs unions) should logically be extended to damage caused by any aspect of trade policy, such as increases in tariffs, non-tariff barriers, import control, agricultural protectionism. It may even be extended to other aspects of external policy, such as a 'closed-door' immigration policy, if it is found that this is harmful to other countries. There is no logical reason to single out economic integration as the one policy giving rise to compensation to third countries.

An important advantage of customs unions over non-preferential tariff elimination resides in the reciprocity of tariff concessions. Reciprocity is a basic principle of the GATT, and its value is highlighted by the hard bargaining which takes place at every multilateral trade conference.

It is often said that customs unions are both a movement towards free trade and protection, but this is not entirely correct. Protection depends on the height of the common external tariff; if it is lower than the tariffs of some of the members before union,

it cannot be said that the union has moved towards protection. It would be more accurate to say that customs unions are a move towards free trade and towards discrimination.

In the above survey of customs union theory, it is noteworthy that the analyses always consider the effects of the formation of customs unions, and never the effects of the breaking-up of a union. Let us assume for a moment that, say, the South African Customs Union, comprising the Republic of South Africa, Lesotho, Swaziland and Botswana, imposes a tariff of 25% on imports of a particular product which is produced at the cost of R50 outside the customs union and R60 in South Africa. A buyer, say in Swaziland, will buy the product from the Republic, because to import the product from outside the customs union would cost $R50 + R12,50 = R62,50$ (ignoring transport costs). If the customs union breaks up and each of the four member States imposes the same 25% tariff on imports from each other, the Swaziland buyer will now buy the product outside the union, since it will still cost R62,50, but the product from South Africa will now cost $R60 + R15 = R75$. It could be called trade-diversion, since the trade with one country has been diverted to another country, but if we note that it is a move from high-cost to low-cost source of production, then it is trade-creation (even though the price to the buyer is now higher than before the break-up of the customs union). Would it be a move for the better?

If the formation of customs union could be analytically proved to be detrimental to economic welfare - and no such proof has yet been worked out - then logically the break-up of customs unions should be beneficial.

The argument could be carried further, to consider the results of breaking up of other customs areas, for instance, putting up tariff barriers between the different provinces of the Republic of South Africa, between the States of the United States of America, or between England, Wales and Scotland. Customs unions enlarge customs areas. It is often forgotten that the existence of any customs area - whether or not it follows national borders - includes an element of discrimination since inter-regional trade is given preference over international trade.

In recent years, economists have turned their attention to the special problems of developing countries. Since their usual trade pattern of exporting primary products and importing manufactured goods has not greatly contributed to the economic development of those regions, some developing countries are attempting to form customs unions and free trade areas, in spite of the fact that some doubt remains as to the benefits they are likely to reap from economic integration.⁽¹⁾ The problem centres on the competitiveness or complementarity of the economies. If one of the member countries is more developed than the other, the advanced region will always be ahead in production and technology. Capital will flow to the dynamic area, where the infrastructure will improve comparatively more than in the weaker area, and higher wages will attract the best labour from the poorer region thus depressing it further.

(1) See Kahnert, F. et al, Economic Integration among Developing Countries, Paris, Development Centre of the Organisation for Economic Co-operation and Development, 1969.

'This argument may or may not be correct. But the important thing is to realise that, at the present state of the theory and of the evidence on this subject, it is impossible to know whether, or in what circumstances, the argument is correct or not.'⁽¹⁾

Examples of integration among developing countries are the East African Economic Community, the Central African Customs and Economic Union, the Latin American Free Trade Area, the Central American Common Market, and the free trade areas which nineteen African countries have formed with the European Community. This last group is the 'hard core' of the Association system of the EEC which will be examined in the next chapter.

To sum up this overview of customs union theory, one can do no better than to quote J.E. Meade, who, after spending a great deal of time and effort refining the theory, wrote that if he were a citizen of a Benelux country, he would support it strongly even if a careful estimate suggested that it was more likely to reduce rather than to raise economic welfare in the narrow sense of the term, because:

'It is becoming a truism that with modern developments of transport, communications, and technology larger social and political units are likely to be more viable and self-reliant politically and strategically. I am quite certain that there is a need for a greater integration of the countries of the free world. Politically it would give greater coherence and strength. Economically any move towards economic union covering a large number of countries would undoubtedly serve to raise standards of living.'⁽²⁾

(1) G.R. Denton (ed.), Economic Integration in Europe, (John Pinder, Problem of European integration)... p. 153.

(2) J.E. Meade, The Theory of Customs Unions, Amsterdam, North-Holland, 1955, pp. 114-115.

CHAPTER IIITHE ASSOCIATION SYSTEM OF THE EUROPEAN ECONOMIC COMMUNITY

Basis of the Association - different types of agreements - Association under the Treaty of Rome - Yaounde I and II - special association agreements - trade agreements - criticisms of the Association system.

The Association system of the European Economic Community was established in 1957 to govern relations between the Six and their dependencies in the field of trade and co-operation. The legal basis for this relationship can be found in article 131 of the Treaty of Rome which reads: 'The purpose of this Association shall be to promote the economic and social development of the countries and territories and to establish close economic relations between them and the Community as a whole.'⁽¹⁾ Since then, the Association has altered in nature, size and complexity.

As this thesis is concerned with the impact of the Association on international trade policies, the nature and evolution of this system must first be outlined. The purpose of this chapter is therefore to explain the Association system and the different types of agreements involved, and to examine the reaction of non-members and the various criticisms which have been aimed at the Association since its inception.

It is important, at the outset, to differentiate between three types of agreements which are in force at the moment:-

(1) See Annex A for relevant articles of the Treaty of Rome, 1957.

(A) The most important and most widely-known type of agreement is the Yaounde agreement which established the Association of African and Malagasy States (AAMS). This includes eighteen ex-dependencies of members of the EEC and was joined in 1972 by Mauritius. These countries are often called the Yaounde Associates, as the Convention was signed at Yaounde, in the Cameroon. This may be regarded as 'full' Association.

(B) A special type of Association was created under Article 238 of the Rome Treaty : 'The Community may conclude with a third country, a union of States or an international organisation, agreements creating an association embodying reciprocal rights and obligations, joint actions and special procedures'. These agreements are sui generis, some of them leading up to future membership, as in the case of Greece and Turkey, whilst others only envisage a limited Association, as is the case for the East African territories since the Arusha agreement of 1969. This is sometimes called 'special' or 'partial' association.

(C) Lastly, the EEC has entered into purely commercial agreements with certain countries, mostly in the Mediterranean area, but also recently with members of the European Free Trade Association which did not join the Common Market. It is not always easy to distinguish between special association agreements and trade agreements. Some writers may prefer to omit trade agreements from a review of the Association system, but they are included here because, in spite of the fact that countries which enter into trade agreements with the EEC are not associates, the links they form with the Community are of a similar nature to those formed by special association agreements. Before examining the most important agreements, fig.12 below illustrates the Association system as it stands at the time of writing.

	<u>Date of agreement</u>
A. <u>YAOUNDE AGREEMENTS</u> (full association)	
1) Association under Part IV of the Treaty of Rome with dependencies of France, Italy, Belgium and the Netherlands. (1)	1957
2) Association of African and Malagasy States (AAMS): Yaounde Convention I.	1963
3) AAMS renewed: Yaounde Convention II.	1969
Signatories of Yaounde I and II:-	
Burundi, Cameroon, Central African Republic, Chad, Congo, Zaïre, Dahomey, Gabon, Ivory Coast, Malagasy Republic, Mali, Mauritania, Niger, Rwanda, Senegal, Somalia, Togo and Upper Volta.	
Mauritius joined the Yaounde associates in	1972
B. <u>SPECIAL ASSOCIATION AGREEMENTS.</u> (<u>sui generis</u>)	
1) Aiming at full membership:	
Greece	1961
Turkey	1963
2) Others:	
(a) Mediterranean area:	
Morocco	1969
Tunisia	1969
Malta	1971
Cyprus	1972
Algeria	negotiating
(b) Africa:	
Nigeria: (Lagos Convention)	1966
Kenya, Uganda, Tanzania: (Arusha Convention)	1968 and 1969
C. <u>TRADE AGREEMENTS</u>	
1) Mediterranean area:	
Iran	1963
Lebanon	1964
Israel	1964
Spain	1970
Yugoslavia	1970
Egypt	1972
2) EFTA countries:	
Sweden, Norway, Finland, Iceland, Portugal, Austria and Switzerland	1972 - 1973
3) Others:	
Argentina	1971
Uruguay	1973

Fig.12. The association system as at 1st September, 1973.

(1) See Annex B for full list of 1957 associates.

A. YAOUNDE AGREEMENTS

These agreements lead to the most comprehensive type of association, but without prospect of eventual membership to the Common Market, since according to Article 237 of the Treaty of Rome, only European countries may join the Community. The number of countries involved in 1957 decreased slightly when the first arrangement was replaced by the Yaounde Convention of 1963, renewed in 1969. Thus the Association progressed through three stages: 1) Association under the Treaty of Rome, 1957 - 1963; 2) Association of African and Malagasy States created by the Yaounde Convention, 1963 - 1969; 3) The Second Yaounde Convention, since 1969. An examination of each stage will explain the nature of the relationship between the EEC and the Yaounde associates.

1) Association under the Treaty of Rome, 1957.

The basis of this association is outlined in Part IV of the Rome Treaty, Articles 131 to 136.⁽¹⁾ The purpose of the Association is to promote the social and economic development of those territories which were dependencies of EEC members, and to establish close economic relationship between those countries and the Community. The Association system contains two main elements, namely, rules regulating trade between the EEC and associates, and financial aid. The territories concerned were listed in Annex IV of the Treaty of Rome. They included French and Dutch dependencies, the Belgian Congo, the Trusteeship of Ruanda-Urundi and Italian Somaliland.⁽²⁾

The background to the inclusion of Articles 131 - 136 in the Treaty of Rome was as follows. When the Six decided to form

(1) See Annex A.

(2) See Annex B for list of territories associated under Part IV of the Treaty of Rome, 1957.

the EEC, those members who still had dependencies asked that a solution be found to avoid breaking the links between the Metropolitan countries and those dependencies, a severance which could have had detrimental effects on both sides. France suggested extending the economic union to colonies but this was rejected, especially by Germany. It must be remembered that Germany had lost her colonies at the end of the first World War and this may have influenced her views. France, however, took the position that she would not join the EEC unless some arrangement was made with regard to those territories. Although France was the most interested party, due to the size of her colonial empire, one must not underestimate the interest of Belgium and Italy in the matter. After a great deal of discussion and negotiations which at times threatened the creation of the EEC, the Association arrangements were accepted by all members.

The main features of the 1957 Association were:-

- (a) Financial aid to the associates, through the establishment of a European Development Fund.
- (b) Gradual abolition of tariffs between the EEC and the associates, and between the associates themselves, except where international obligations prevented this, but with authorization to levy customs duties in certain circumstances, such as for the protection of infant industries.
- (c) Absence of discrimination between members of the EEC with regard to the application of these duties.
- (d) Freedom of movement for workers between the associated territories and the EEC.
- (e) Right of establishment of nationals and companies of EEC members in those territories.

There were a few exceptions to the preferential system thus established. For instance, Germany was allowed a duty-free quota for the import of bananas from non-associates, while Italy and the Benelux countries were granted a similar quota on unroasted coffee.

The 1957 Association set up a free trade area between the Six and their dependencies. A customs union already existed between France and her colonies, but not between Belgium and the Congo, because the Congo Basin Treaties of 1885 and 1890 precluded discrimination in customs matters.⁽¹⁾ The main change introduced by the Rome Treaty, Part IV, was the extension of this Common Market to other members of the EEC. From 1957 onwards, all members of the Community began to abolish tariffs on goods from those territories, thus giving exports from associates preferential treatment over exports from non-associates.

The Association system set up by the EEC was criticized from the start by a number of third countries (that is, countries which are not party to an arrangement with the EEC). 'The creation of this preferential system evoked loud protests in the GATT from Latin American and other African countries such as Ghana who claimed that this preference would seriously harm their exports to the member states.'⁽²⁾ This particular aspect will be examined in Chapter V, the problem of the GATT rules will be the subject of Chapter VII, and other criticisms of the Association will be considered on pages 84 - 87. It must be stressed here, however, that the preferential regime between France and her overseas territories, and between the Benelux countries and their dependencies, was allowed under the GATT. Article 1(2) of the General Agreement

(1) See J. Matthews, Free trade and the Congo Basin Treaties, South African Journal of Economics, Vol. 27, no.4, December 1959, pp. 293 - 300.

(2) Werner Feld, The European Common Market and the World, New Jersey, Prentice-Hall, 1967, p.115.

specifically allows long-standing preferences such as these (see Annexes A, B and C of the Agreement). It is only the extension of these preferential arrangements to other members of the EEC which was vulnerable under the GATT rules.

2) First Yaounde Convention, 1963

Soon after 1960, most of the African territories associated with the Common Market gained independence. Since new African states could not be bound by the Treaty of Rome, which had been signed only by the Six, a new arrangement was required. The issue was complicated by the prospect of British entry into the EEC, because Britain wanted to establish a link between the Community and the Commonwealth countries, possibly an extension of the Association, at least to African countries. Moreover, differences of opinion were apparent between members of the EEC as to the form of the prospective Association. By January 1963, however, without waiting for the result of the British negotiations, an agreement was reached between the Six and eighteen of the 1957 associates and a Convention was signed at Yaounde, Cameroon, in July 1963, establishing the Association of African and Malagasy States (AAMS). The eighteen were: Burundi, Cameroon, Central African Republic, Chad, Congo, Zaïre, Dahomey, Gabon, Ivory Coast, Malagasy Republic, Mali, Mauritania, Niger, Rwanda, Senegal, Somalia, Togo and Upper Volta.⁽¹⁾ Guinea refused to join the AAMS.

Part IV of the Treaty of Rome remained effective and deals with relations between the EEC and the remaining dependencies of France and the Netherlands: New Caledonia, French Polynesia, Wallis and Futuna, the Comores Islands, French Territory of the Afars and Issas, Saint Pierre and Miquelon, the French Southern and

(1) Somalia includes Italian and British Somaliland; French Somaliland is now the French territory of the Afars and Issas.

Antarctic territories, Surinam and Netherlands Antilles. The Association between the EEC and Netherlands New Guinea ended in 1963, when this country became part of Indonesia. The 1957 Association does not apply to the French overseas departments of Guiana, Martinique, Guadeloupe and Réunion.

Although the Yaounde Association had the same broad purpose as the earlier arrangement, namely trade expansion, financial aid and the right of establishment, there were several differences between the two systems:

(a) Whereas the 1957 Association was signed by the Six on behalf of their dependencies, the Yaounde Convention was agreed upon by the Common Market countries and eighteen associates. Thus, the earlier system was an arrangement by Metropolitan countries dealing with their colonies, while the 1963 Convention was freely agreed upon by newly-independent African states. The point has sometimes been raised as to whether those developing countries were in fact free to adhere to the Association established at Yaounde, since they were economically dependent on the continuation of this arrangement. But although the eighteen may have needed special links with the EEC, they were at liberty, legally and constitutionally, to sign the Convention or remain out of the new scheme, as illustrated by the fact that Guinea, once a French colony, decided to withdraw from the group of the 1957 associates, and has remained outside the Association.

(b) The Treaty of Rome, Part IV, provided for the abolition of customs duties between the Six and the eighteen, and also between the associates, thus establishing one large free trade area. The Yaounde Convention, on the other hand, established eighteen free trade areas, between the EEC and each of the eighteen associates. ⁽¹⁾

(1) There were a few exceptions. Agricultural products competing with the EEC products receive preferential treatment instead of free entry into the Community. Due to international obligations, Zaïre and Togo do not give preferences to EEC

The reason for this, is that inter-associate trade is outside the scope of the Convention. The associates are free to organise their trade with each other, and with third countries, as each of them thinks fit. Article 8 of the Convention of Association states that 'this Convention shall not preclude the maintenance or establishment of customs unions or free-trade areas among Associated States', and Article 9 reads 'this Convention shall not preclude the maintenance or establishment of customs unions or free-trade areas between one or more Associated States and one or more third countries insofar as they neither are nor prove to be incompatible with the principles and provisions of the said Convention'. So far, five associates have formed an economic union: l'Union Douanière et Economique de l'Afrique Centrale (UDEAC) created in 1964 between the Congo, Gabon, Central African Republic, Chad and Cameroon, but none have attempted integration with non-associates.

The fact that the Yaounde Convention of 1963 established eighteen free trade areas instead of one, as in the case of the earlier Association, is considered by some writers as a backward step. In the sense that the large free trade area has broken up into eighteen free trade areas, it is further away from the ideal of trade liberalisation. On the other hand, the 1957 Association was decided upon by six countries - the EEC - whereas the Yaounde Convention was signed by twenty-four nations and therefore should be accepted as a step forward in international economic co-operation.

(c) Whereas the EEC institutions administered the 1957 Association, Article 39 of the Yaounde Convention provided for an Association Council assisted by an Association Committee, a Parliamentary Conference and a Court of Arbitration.

The salient features of these institutions are as follows:

The Association Council is composed, 'on the one hand, of the members of the Council of the EEC and members of the Commission of the EEC, and on the other hand, of one member of the Government of each Associated State' (Article 40).

'The Association Council shall express itself by mutual agreement between the Community on the one hand and the Associated States on the other. The Community ... and the Associated States ... shall each by means of an internal Protocol determine their procedure for arriving at their respective positions' (Article 43).

This means that each side has only one vote, and that all decisions must therefore be reached by unanimity. The main functions of the Council are consultation, deliberation and supervision over the implementation of the Convention. It is assisted by an Association Committee, which has assumed considerable significance since the Council only meets once a year.⁽¹⁾

The Parliamentary Conference consists of an equal number of delegates from the European Assembly and from the parliaments of the associated states, but as in the case of the European Assembly, its powers are very limited. It meets once a year.

The Court of Arbitration judges disputes concerning the interpretation and application of the Convention and can make binding decisions if prior amicable settlement by the Council has failed. It is composed of five members: a President, appointed by the Council, and 'four judges chosen from among persons whose independence and competence can be fully guaranteed' (Articles 51 and 52).

(1) Werner Feld, The European Common Market and the world, , p. 115.

(d) Apart from the above changes, the Yaounde Convention differed from the 1957 Association on a few other minor points. On the other hand, escape clauses were retained such as in Article 13, which allows one or more associated states to take measures such as tariffs and quantitative restrictions, 'if serious disturbances occur in one sector of the economy or jeopardize its external financial stability', and in Article 3 which permits associates to retain or even introduce customs duties which 'correspond to their development needs or their industrialization requirements or which are intended to contribute to their budget'.

3) Second Yaounde Convention, 1969

Some doubts were expressed in various quarters as to whether the Yaounde Convention would be renewed after its expiration in 1969. Besides differences of opinion between EEC members as to the content of the future Convention, especially between France and Germany, there was evidence of pressure on the EEC, from non-associated countries, mainly Latin America, not to renew the Convention. The group of '77', of the United Nations Conference for Trade and Development (UNCTAD) was actively trying to establish the Generalized Scheme of Preferences (GSP) whereby developed countries would give preferential treatment to manufactured goods from developing nations, and this was felt by some to be an alternative to the Association preferential system.⁽¹⁾ However, the associates pressed for the renewal of the Convention, and this was carried out at Yaounde in July 1969.

In terms of this Convention, certain provisions on financial aid were altered, the Six increasing the European Develop-

(1) See Chapter VIII. The group of '77' is made up of active developing countries, within the framework of UNCTAD, and actually comprises 96 countries.

ment Fund's resources from \$ 730 million for the 1964 - 69 period, to \$ 918 million for the next five years. However, the African associates had hoped for a bigger increase and expressed dissatisfaction. In order to reduce the discriminatory effects of the agreement on the trade of non-associates, the common external tariff of the EEC was lowered for some products, e.g. coffee, cocoa beans, palm oil. This reduction in the margin of preferences upset the associates, but it was a compromise, between the conflicting demands of the two groups: the associates wanting to perpetuate preferential treatment, and third countries wishing to minimize it.

Extension of the Yaounde Association to Mauritius. Article 58 of the Yaounde Convention provides for accession to the Association, of 'States which have an economic structure and production comparable to those Associated States'. Mauritius is the first country to have become associated under this provision. By an agreement signed in May 1972, the EEC will grant Mauritius duty-free access for most of her exports to the Community, as far as industrial goods are concerned. Farm produce will receive preferential treatment but sugar is temporarily excepted. This is because Mauritius sugar benefits from a guaranteed outlet to the U.K. under the Commonwealth Sugar Agreement, and this will continue until 1975. The EEC will then negotiate new arrangements for sugar for those associated developing countries whose economies are highly dependent on sugar exports. On the other hand, Mauritius will grant EEC goods the same treatment as she grants the Commonwealth, by the end of 1974. This agreement brings the number of Yaounde associates to nineteen. Mauritius is the first Commonwealth country to become 'full associate' (although it must be remembered that ex-British Somaliland, as part of Somalia, was associated in 1963). Other

Commonwealth members have entered into association agreements sui generis.

B. SPECIAL ASSOCIATION AGREEMENTS

In the last decade, the Community has entered into a variety of Association agreements with non-member countries. The Treaty of Rome provides for these agreements in Article 238: 'The EEC may conclude with a non-member state, a union between states or an international organisation, agreements creating an association characterised by reciprocal rights and obligations, communal actions and particular procedures'.

The terms of these arrangements vary. Most of them establish preferential entry into the EEC, for exports from associates and the so-called 'reverse preferences', that is, preferential entry into the associated countries, for exports from the EEC. Several associates receive financial aid, others do not. Agreements are signed for a specific period, usually three to six years. They are renewable and revokable according to a procedure laid down in each agreement. A brief outline of the most important of these agreements will suffice to illustrate their diversity. 'Special' associates are situated in two main areas: the Mediterranean region and Africa.

1. Mediterranean region

Most countries bordering the Mediterranean have entered into agreements with the EEC, Albania, Syria and Libya being exceptions to the rule. Algeria is negotiating. Some of these arrangements have established an association with the Community, whilst others have been simple trade agreements, which will be discussed below.

Among the association agreements sui generis, a distinction must be drawn between those entered into with a view of eventual

membership of the EEC and those which do not envisage this possibility. Only the agreements with Greece and Turkey aim at full membership of the Community.

Greece and Turkey. As the Association agreements with these two countries are similar, they can be examined together. Greece became an associate in 1961, and Turkey in 1963. Article 2 of each agreement states that the long-range objective is

'to promote a continuous and balanced strengthening of the commercial and economic relations between the contracting parties with full consideration of the need to ensure the accelerated development of the economy of (Greece, Turkey) as well as the elevation of the level of employment and of the living standards of the (Greek, Turkish) people'.

To achieve this, the intermediate objectives are a customs union between the EEC and each country and the harmonization of economic policies, while the long-term aim is full membership.⁽¹⁾ The establishment of the customs union will not take place according to the same time-table since the states of the economies of Greece and Turkey differ.

In the agreement with Greece, it was decided that customs duties would be abolished over a 12-year period except for a few items which needed protection, in which case the period would extend to 22 years. Turkey, with a lower level of development, was to go through a 'preparatory' period during the first five years, when the Community would give preferential tariff quotas to Turkish exports of tobacco, dried grapes and a few other commodities representing about 40% of Turkey's exports to the EEC. This would be followed by the 'transition' period, during which Turkey and the EEC would move towards a customs union. At the time of writing, Turkey is entering the transition stage. While the agreement with

(1) On this subject, see Werner Feld, The European Common Market and the world, pp. 59-69.

Turkey progressed according to plan, the arrangement with Greece suffered a setback with the 1967 coup d'Etat.

The institutions provided for under these agreements are similar to those of the Yaounde Association, as outlined in the previous discussion. Councils of the Association, composed of members of the EEC organs and of members of the Greek or Turkish governments, have an element of supranationality, and may take decisions binding on all partners. These Councils have established Association Committees to ensure the smooth operation of the agreements. In addition, Parliamentary Association Committees have been set up as advisory bodies composed of an equal number of deputies from the European Assembly and from the Greek or the Turkish Parliament.

Morocco and Tunisia. The Maghreb⁽¹⁾ countries have had historical ties with Spain, France and Italy for many centuries. Subsequently, Morocco and Tunisia became French Protectorates, while Algeria became part of France. The former countries acquired independence in 1956, and Algeria in 1962, after an eight-year war.

Agreements with Morocco and Tunisia were signed in 1969, establishing 'partial' association, in the sense that they do not contain provisions for financial aid and for the free movement of labour. The Six have undertaken to remove customs duties and quotas on most industrial exports and to grant preferences on agricultural products from these countries. The main problem of this Association is the competitive aspect of their farm products. Not only do their exports of fruit, vegetables and wine compete with French and Italian goods, but Maghreb oranges also compete with those from the Lebanon and Israel, with whom the EEC entered into trade agreements in 1964.

(1) 'Maghreb' is an Arab word meaning 'west', and the term is used to describe the western part of the Arab-speaking world, that

Algeria. Political differences have hampered association with Algeria. Algeria was originally due to participate in the Community's negotiations with Morocco and Tunisia, but its declaration of war on Israel in 1967 provoked a veto from the Netherlands.⁽¹⁾ More recently, this veto has been lifted, and negotiations are proceeding. In the meantime, Algerian wine enters the Community with a 40% reduction of the Common External Tariff.

Malta. An association agreement providing for customs union between the EEC and Malta was signed in 1970, mainly for industrial products. As Malta benefits from the Commonwealth Preferential system, she will have to give the Community treatment at least as favourable as she gives to the United Kingdom, by the end of the first five years. The Prime Minister of Malta has recently asked for a revision of the agreement to include financial aid and agriculture.

Cyprus. The association agreement with Cyprus was signed in 1972, and came into effect in February 1973. The agreement aims at removing virtually all trade barriers between Cyprus and the Nine, over a period of 9½ years. The EEC makes an immediate tariff cut of 70% on industrial goods, (except petroleum products), while Cyprus reduces her tariffs by 35% over 4 years. The main problem was sherry exports to Britain and Ireland: Cyprus will be given two years' grace before full application of the common agricultural policy.⁽²⁾

2. Africa.

Nigeria. In 1966, the Lagos Convention was signed by the EEC and Nigeria. This was a turning point in the development of the

(1) European Community, September 1970, p.13

(2) European Community, February 1973, p.26.

Association system. For the first time, a country without political or historical ties with the Common Market entered into association with the Community. Moreover, this was a Commonwealth, English-speaking country. The main reason behind this move was the substantial trade which Nigeria carried out with some members of the EEC. Nevertheless, it was a bold step for a Commonwealth country to take, especially after the breakdown of the first British negotiations for entry.⁽¹⁾ The significance of the Association with Commonwealth countries will be examined in Chapter IV.

Similarly to other association agreements sui generis, the terms of the Lagos Convention are more limited than those of Yaounde. Institutional links are kept to a minimum, and Nigeria did not ask for financial aid.

'Nigeria's rejection of assistance from the EEC overseas Fund or of any financial co-operation with the Community (although she accepted aid from the member states on a bilateral basis) served to demonstrate that an association agreement could cover the trade needs of a developing country without tying the country to multilateral aid and, therefore, multipolitical pressure.'⁽²⁾

The EEC gave duty-free entry quotas to Nigeria's most important exports (palm products, cocoa, tropical timber and groundnut oil), whereas the Yaounde associates were given unlimited free entry into the Common Market. In return, Nigeria dropped customs duties on 26 items from the Six, which accounted for only 4% of her total imports.

The Lagos Convention never came into effect, however, due to the civil war which ravaged Nigeria later that year. The possibility exists of a renewal of the agreement, however, following Britain's entry into the Common Market. (See Chapter IV).

(1) For details on Nigeria's position, see P.N.C. Okigbo, Africa and the Common Market, London, Longmans, 1967

(2) P.N.C. Okigbo, Africa and the Common Market,, p.132.

Kenya, Tanzania, Uganda. Following in the footsteps of Nigeria, these three East African countries became associates of the EEC by the Arusha Convention of 1968, renewed in 1969, at the same time as Yaounde II. The Arusha agreement provided for substantial liberalization of EEC imports from Kenya, Tanzania and Uganda, and duty-free quotas for coffee, cloves and tinned pineapples. In return, the associates granted preferences of between 2% and 9% on a group of about 59 EEC products.

C. TRADE AGREEMENTS

Besides association agreements, the EEC has signed a number of trade agreements with third countries, mainly in the Mediterranean area. This is to cover cases where countries wish to make some commercial arrangement with the EEC, but prefer not to become too closely linked with the Community.

Iran. In October 1963, Iran entered into a trade agreement with the EEC, in order to protect the exports of a number of products to the Common Market, especially rugs, raisins, dried apricots and sturgeon caviar. The agreement covers tariff reductions of 10% to 20% and other concessions. (Greece, associated since 1961, was upset by the concession regarding raisins, which compete with Greek exports). A Joint Committee consisting of EEC and Iranian officials, was established to attend to the implementation of the agreement.

Israel. For several years, Israel has been seeking a formal relationship with the EEC, but negotiations have been slow and difficult for economic and political reasons. Inter alia, Israel exports compete with Italian products, especially citrus fruit. A trade agreement dating from 1964 was renegotiated in

1970, but in the meantime Israel has applied for associate status, and the Six have viewed their talks with this country as part of the Community's relations with the Middle East.

Lebanon. A trade agreement between the Lebanon and the EEC was signed in May 1965. Tariff reductions were not included, but the agreement concentrated on the mutual extension of most-favoured-treatment, including non-tariff obstacles and technical assistance. In 1972, a preferential agreement was signed, covering 58% of Lebanon's industrial exports to the Community and almost 40% of its farm exports. As in the Israeli agreement, a Joint Committee has been provided for, to supervise the running of the agreement.

Yugoslavia. A three-year, non-preferential trade agreement was signed in 1970. This is the first agreement between the EEC and an East European country.

Spain. Although Spain has expressed interest in the Association, there has been opposition from the Benelux countries, towards anything that could be construed as giving political approval to the Spanish government. As a compromise, a trade agreement between Spain and the EEC was signed in 1970, liberalizing trade on both sides for a period of six years. This will benefit over 95% of Spain's industrial exports and 62% of its agricultural exports to the Six, and 61% of the Community's total exports to Spain.⁽¹⁾

Egypt and the EEC signed their first five-year trade agreement in December 1972. It provides for a tariff cut of 55% by the EEC on imports from Egypt, but quotas restrictions will remain on petroleum and cotton products. There will also be significant concessions in the agricultural sector. In return,

(1) See European Community, September 1970, p.10.

Egypt will grant tariff concessions on industrial imports from the EEC.

Argentina. In November 1971, the Common Market signed a trade agreement with Argentina, the first Latin American country to establish formal links with the Community. The three-year, non-preferential treaty reduces restrictions on imports to the EEC of beef and veal (Argentina's main products) and encourages exports of manufactures from both sides. The agreement also sets up a joint commission for consultation on commercial and economic matters. This agreement will act as a model for agreements with other Latin American states.⁽¹⁾

Uruguay. A non-preferential trade agreement was signed this year (1973), for a period of 3 years.

EFTA countries. Until recently, most members of the Association system were developing countries. A new development is the formation of a free trade area with those members of EFTA which did not join the EEC. Sweden, Norway, Finland, Switzerland, Austria, Portugal and Iceland have all entered into trade agreements with the enlarged Community to avoid raising tariffs between EFTA countries and the new EEC members, Britain and Denmark. Apart from a few sensitive products such as paper, the new arrangements will create free trade in industrial products between sixteen countries of Europe.

D. CRITICISMS OF THE ASSOCIATION SYSTEM

Many countries reacted adversely to the establishment of the Association system, both in 1957 and since the Yaounde Convention of 1963. The reasons varied. In some cases, criticisms

(1) See European Community, December 1971, p.6.

came from developing nations which feared that their trade with the EEC would suffer due to their exclusion from the preferential treatment given to associates. More general criticisms were that the Association divides Africa into two groups, associates and non-associates, and that since it creates a new preferential area, it infringes the rules of the GATT. Moreover, it was alleged that the Association is a form of neo-colonialism, while some writers have attacked the system because it has failed to develop the associated countries! Some of these criticisms will be considered in detail, others more briefly.

The most serious allegation is undoubtedly that the Association will cause damage to the external trade of non-associates, while exports of associates to the EEC will benefit from the trade arrangements with the Community. Obviously, associates hoped that a free trade area with the EEC would expand their exports to the Community, but it was generally assumed that this would occur without a reduction of the trade between the EEC and other developing countries, but simply because of economic growth in the Community. In Chapter V, trade figures of associates and non-associates will be compared to assess the validity of this argument.

It is true that Africa may be divided into associates and non-associates but this is certainly not a new division. Since the 'scramble for Africa' in the 19th century, Africa has been divided, mainly into French-speaking and English-speaking Africa, and more recently into Commonwealth and non-Commonwealth countries. As will be shown in Chapter IV, the Association system is not an exclusive group and several Commonwealth nations have already become associated with the Common Market, thus merging the two preferential

systems. This trend will be reinforced if other Commonwealth countries join the Association system, due to Britain's entry into the EEC.

The conflict between association and trade agreements, and the rules of the GATT is a lasting problem. The basic cause of the conflict may be attributed to the duality of regional arrangements: freer trade between the parties involved, discrimination against third parties. Most agreements are based on the principle of free trade areas. In some cases, they form a customs union (e.g. Spain, Malta). The EEC stresses the fact that, as members of free trade areas, associates are free to impose tariffs of their own choice on third parties. On the other hand, the GATT refers to most agreements as being preferential in character, and giving rise to the notorious 'reverse preferences'. This problem will be examined in detail in Chapter VII.

The last two criticisms mentioned above will be considered briefly. If the term 'neo-colonialism' is taken in a broad sense, to mean a certain economic dependence on the EEC, on the part of associates, then the allegation may be defended. On the other hand, if 'neo-colonialism' is defined as the perpetuation of colonial links, there is no evidence of this in the arrangements between the EEC and those independent states which have joined the Association system. The institutions set up by the Yaounde Convention give equal status to both sides. 'To regard association as a manifestation of collective neo-colonialism in its pejorative aspects, wholly misinterprets both its conception and functions.'⁽¹⁾

Finally, the Association system was never meant to be a magic formula to solve the development problems of the associates.

(1) Carol Ann Cosgrove and Kenneth J. Twitchett: The second Yaounde Convention in perspective, International Relations, vol. III, no. 9, May 1970, p. 686.

Trade and aid arrangements between those countries and the European Community may help, but it is well-known that development problems are enormous and may remain unsolved, at least in the foreseeable future.

This review of association and trade agreements illustrates the diversity of the system which includes ex-dependencies of the Six, some Commonwealth countries, and other nations with no historical ties with the Community. Changes may occur if the negotiations between the enlarged EEC and other Commonwealth countries succeed. Thus the Association system of the EEC has an important impact on Commonwealth trade relationships in Africa, as will be shown in the next chapter.

CHAPTER IVTHE ASSOCIATION-COMMONWEALTH CONVERGENCE

Comparison between the Association and the Commonwealth - similarities - differences - significance of Commonwealth associates - Nigeria - East Africa - Malta and Cyprus - Mauritius - the 'associables'.

The Association system of the EEC was planned to deal with the relationship between Common Market countries and their dependencies but it has evolved into a series of agreements between the Community and a number of independent nations. Most of these countries are ex-dependencies of the Six whilst a growing number are Commonwealth countries, mainly in Africa.

Commonwealth associates - countries which are both members of the Commonwealth and associates of the EEC - provide a link between two preferential systems. The purpose of this chapter is to consider the view that, in Africa, the Association system and the Commonwealth are converging and therefore that the Association has an important impact on the trade policies of Commonwealth African nations. Contributory factors of this trend are the similarities of the two systems and recent changes in the pattern of trade of Commonwealth countries in Africa.

A comparison between the Association and the Commonwealth preferential system will be followed by a consideration of the association agreements between the EEC and certain Commonwealth countries.

A. COMPARISON BETWEEN THE ASSOCIATION AND THE COMMONWEALTH

Although there are political as well as economic elements in both organisations, the main purpose of this discussion is to consider the trade characteristics of the two systems.

The Association system was described in the previous chapter. Although the development of the Commonwealth is well-known, it will be useful to recall the main lines of its evolution.

As British colonies gradually attained independence, a 'Commonwealth of Nations' replaced the British Empire. The first territories involved were the so-called 'White Dominions', Canada, Australia, New Zealand, South Africa and Ireland.⁽¹⁾ Dominion status was given formal recognition by the Statute of Westminster in 1931, but the term 'Dominion' fell into disuse after the Second World War, because of its implication of subordination. Most of the other colonies have since acquired freedom, and have become members of the Commonwealth, perpetuating the 'Crown Link' by recognising the British Monarch as their own. This bond weakened when some members of the Commonwealth became Republics, but they recognise the Queen as Head of the Commonwealth and as a symbol of the free association of its members.

The Commonwealth is not, strictly speaking, a formal organisation, but rather a loose association of independent states. However, as the term 'Association' is used here to mean the association with the EEC, the term 'organisation' will be applied to the Commonwealth.

Thus we see in the evolution of the British Empire into the Commonwealth, a gradual weakening of the bonds which originally

(1) South Africa and Ireland have since left the Commonwealth.

linked the members of the Empire, but also a recognition of the persistence of common ties. These ties are difficult to define, but they are found 'in every sphere - political, economic and cultural. These are the results of history and of a shared association over the years'.⁽¹⁾

The links between members of the Commonwealth are due to a variety of factors, such as a common language, similar traditions in administration and education, similar legal conceptions, migrations of people from one Commonwealth country to another, common interest in sport, and above all, strong commercial ties, due to years of close trade relations and to the establishment of a preferential system. This last characteristic is the most tangible of these bonds.

The solidarity which exists between members of the Commonwealth is sometimes said to be due to the 'Sterling Area'. But this is a result, rather than a cause, of the Commonwealth bonds. Moreover, the Sterling Area is not identical to the Commonwealth since it includes non-Commonwealth countries such as Ireland and Iceland, whereas Canada is a Commonwealth State in the dollar zone.

The economic aspect of the Commonwealth is characterized by the system of Commonwealth Preference - sometimes called by its original name, Imperial Preference - which has sustained the strong commercial links between members. This system was established at the Ottawa Conference of 1932, when a number of bilateral trade agreements were signed between pairs of Commonwealth States. According to these agreements, preferential tariffs were to be applied to imports from the signatories. Not all Commonwealth countries

(1) The future of the Commonwealth: A British view. The Report of a conference held ... at the invitation of the Commonwealth Relations Office ... London, H.M.S.O., 1963. p.4.

were involved, and some countries received preferences from, but did not grant them to Britain.

1. Similarities.

Seven points of resemblance may be distinguished and they are as follows:-

(a) The origin of both the Association and the Commonwealth is the colonial situation which existed between some members of the EEC and their dependencies, and between Britain and her dependencies. Most British ex-colonies decided to remain in the Commonwealth after gaining independence, perpetuating the cultural and historical links forged by years of contact. Similarly, links persist between France and her former colonies, between Belgium and Zaïre, etc. A common language, commercial ties and similar conceptions of law and education exist in both groups of countries.

(b) Accession to the Commonwealth and to the Association is decided freely by independent nations, in spite of the economic dependence of developing nations on their ex-Metropolitan area. In the same way as most ex-British colonies admitted the value of the continuation of their links with the Commonwealth and decided to remain within the group, so the Yaounde countries postulated that Association with the Common Market would be advantageous to their economies, and entered into an agreement with the Community.

(c) The main element common to both Association and Commonwealth, is trade. The most important provision of the Yaounde Convention is the establishment of a free trade area between the EEC and the associates, giving reciprocal preferential treatment to exports from both groups. Similarly, the principal advantages

of the Commonwealth link are the preferential tariffs applied to goods from Commonwealth countries. In both cases, preferences strengthen commercial ties.

(d) There is an element of reciprocity in both systems. Although the benefits given by the Common Market to products from associated countries outweigh the benefits given by these to the EEC, the element of reciprocity preserves the bilateral aspect of the contract. Generally, Commonwealth preferences are also reciprocal, except when debarred by pre-existing commitments such as the Congo Basin Treaties, mentioned below (p.99).

(e) In both cases, preferences have been diluted over the years. Commonwealth preference margins have been narrowed by successive GATT negotiations which reduced tariffs on imports from non-Commonwealth countries.⁽¹⁾ In the same way, new Association agreements reduced the preferential advantages of the first group of associates, namely the Yaounde countries, even though none of the later agreements were as beneficial to the trade of the associates as the Yaounde Convention. The benefits of both the Commonwealth preferential system and the EEC Association will be further reduced by the Generalised Scheme of Preferences. This development will be discussed in Chapter VIII.

(f) Articles 15 - 28, of the Yaounde Convention, deal with financial and technical co-operation, through the European Development Fund and the European Investment Bank of the EEC. Developing Commonwealth states receive considerable aid from Britain.

(1) Specific tariffs are consistently reduced by inflation.

(g) As mentioned in the last chapter, it is sometimes alleged that the Association system of the EEC has divided Africa in two, by separating associates from non-associates. This criticism does not stand up to scrutiny, because prior to the establishment of the Association, Africa was already divided into Commonwealth and non-Commonwealth countries. The root of this goes back to the 19th Century, when the 'partition of Africa' carved the continent into Empires for Britain, France, Germany, Belgium, Italy and Portugal, Germany leaving the field after the first World War. The largest groups were the British and French colonies, which evolved into English-speaking and French-speaking Africa. Both the Commonwealth and the Association have emphasized certain differences, but they have not created them.

The above-mentioned points have indicated the close resemblance of the Commonwealth preferential system and the EEC Association system. It is therefore surprising to recall that several members of the Commonwealth were severely critical of the Association in the early years of its formation, for instance, Ghana.⁽¹⁾

There are however, a few differences between the two organisations which must be mentioned to complete the comparison.

2. Differences.

There are four major differences between the Association and the Commonwealth:

(a) There is a marked diversity between the economies of Commonwealth states. Some are still developing, such as most of

(1) G.R. Denton (ed.), Economic integration in Europe, (Carol Ann Cosgrove, The EEC and developing countries), London, Weidenfeld, 1969, p.131.

the African members, whilst others, such as Canada are predominantly developed countries. Some territories are mid-way between the two, for instance, India. By contrast, all the Yaounde countries are developing areas, and most of them are at a very similar stage of economic development. However, if we limit the comparison to Africa, the similarity persists, since Commonwealth African countries are at a level of development comparable to that of the Yaounde associates.

(b) Article 58 of the Yaounde Convention of 1963 deals with 'the request for association with the Community made by a State which has an economic structure and production comparable to those of the Associated States...' Thus the door is left open for other developing countries to enter into Association with the EEC. This is not the case for the Commonwealth. Although no Convention was signed regarding membership of the Commonwealth, and therefore no rules were laid down, it is generally accepted that only ex-members of the British Empire are eligible for the status of Commonwealth member, and hence, for the benefits of Commonwealth preferences. The conclusion can thus be drawn that the Association is open to third countries, whilst the Commonwealth is an exclusive group.

(c) As mentioned previously, the Yaounde Convention set up a number of institutions to watch over the application of the provisions of the agreement. In contrast, the only outward evidence of Commonwealth consultation is the occurrence of periodic meetings of Commonwealth Prime Ministers and the existence of a Commonwealth Relations Office now incorporated in the Foreign and Commonwealth Office, London. Thus the Association is a more formal

type of organisation than the Commonwealth.

(d) Chronologically, the Commonwealth is a much older structure than the Association. The formal start of the Commonwealth can be attributed to the Statute of Westminster in 1931, although some Dominions became independent at a much earlier date. On the other hand, the principle of Association dates from 1957, when the Treaty of Rome was signed by the Six, and was formally agreed to by the associates in 1963.

This difference in time of the initiation of the two systems is particularly important in relation to GATT. When the General Agreement on Tariffs and Trade was signed in 1947, it exempted from the principle of non-discrimination 'certain preferences of long-standing'.⁽¹⁾ This met the special problem of existing preferential arrangements of the Commonwealth, the French Union and a few others, which the countries involved did not want to abolish. Thus the Commonwealth preferential system is legal under GATT, whereas the Association preferences have evoked considerable criticism from the Contracting Parties, since they created a new preferential area. This aspect will be examined in greater detail in Chapter VII.

Despite these differences, the EEC Association and the Commonwealth preferential system resemble each other in nature, origin and purpose. These fundamental similarities have contributed to the growing amalgamation of the two organisations.

B. CONVERGENCE BETWEEN THE ASSOCIATION AND THE COMMONWEALTH.

The nature of the Association-Commonwealth convergence is illustrated by Commonwealth associates, that is, Commonwealth

(1) See Annex D, article 1 of the GATT.

countries which have signed the association agreements with the EEC without leaving the Commonwealth, namely Nigeria, Kenya, Tanzania, Uganda, Malta, Cyprus and Mauritius. It is of interest to examine certain aspects of these agreements.

Nigeria. Although the Lagos Convention of 1966 was not put into effect because of the Nigerian civil war of that year, this agreement has great significance in terms of the principles involved. It represents the first association agreement negotiated between an anglophone Commonwealth country and the EEC, in spite of objections raised by other members of the Commonwealth and attacks on the Association system, such as that of Dr. Nkrumah : 'We have said and will continue to say, that the Common Market is an imperialist device for the collective exploitation of the less developed countries of Africa by the protagonists of neo-colonialism. It must be avoided like the plague'.⁽¹⁾

Nigeria's move was a bold one. It was a departure from a previous non-discriminatory policy, because although Nigeria benefitted from preferences in the British Market, she did not give preferences to imports from Britain or other Commonwealth countries. The origin of this 'open door' policy is the Anglo-French Convention of 1898, which defined British and French spheres of influence in West Africa and which gave equal commercial rights to both countries in Nigeria. Although the Treaty lapsed in 1937, Britain did not introduce preferences in Nigeria.

Nigeria's decision to enter into an Association agreement with the EEC was not taken lightly. There were two main reasons. The first was the negotiations between Britain and the Common Market, with all the repercussions which British membership of the EEC would

(1) Ghana Parliamentary Debates, 25 September 1962.

have on Commonwealth trade.

'Between 1958 and 1962, the first serious attempt to build a link between the two blocs (Francophone and Anglophone Africa) stemmed from Britain's application to join the Community. The negotiations that followed had serious implications for Commonwealth African countries and for the future development of intra-African trade'.⁽¹⁾

If at this time, Britain had succeeded in joining the EEC, Nigeria's exports to Britain would have had to meet the common external tariff of the Community, losing her preferential treatment in UK markets. By signing an association agreement giving Nigeria certain tariff reductions in the EEC, Nigeria's representatives were compensating for this eventuality, even though the preferences thus established were not equal to preferences lost in Britain.

The other reason was a change in the external trade pattern of Nigeria (see table 1.)

TABLE 1

Nigerian Foreign Trade (Millions of £ sterling)

		<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>
<u>Exports</u>	Total	161	161	170	164	185	211
	U.K.	82	77	77	70	74	81
	E.E.C.	56	50	60	57	69	77
<u>Imports</u>	Total	178	215	216	203	208	254
	U.K.	81	91	95	74	71	79
	E.E.C.	33	42	44	39	45	59

Sources: Nigerian Trade Summaries: Commonwealth Economic Committee - Commonwealth Trade 1964. U.K. Board of Trade. Reproduced in P. Uri, (ed.) From Commonwealth to Common Market, Harmondsworth, Penguin, 1968, p.146.

(1) Okigbo, Africa and the Common Market, London, Longmans, 1967, p.70.

'Expressed as percentages, Nigeria's exports to the EEC increased only very slightly from 34.7 per cent of total exports in 1959 to 36.4 per cent in 1964. But exports to the United Kingdom fell from over 50 per cent to just under 40 per cent of total exports.'⁽¹⁾

Imports into Nigeria increased in absolute terms from the EEC, and decreased from the U.K., in spite of an overall increase of total imports. These trade figures explain why Nigeria felt it necessary to come to terms with the Common Market.

Having recognised the advisability of some arrangement with the EEC, Nigeria was faced with three choices, accession to the Yaounde Convention in accordance with Article 58, an association agreement sui generis, or a commercial agreement.

Nigeria opted for an association agreement sui generis, and negotiations were followed by the signing of the Lagos Convention in July 1966. This was the first step in the creation of a bridge between the Commonwealth and the Association.

'The Nigerian link between French-speaking and English-speaking Africa is important, symbolically and (to a lesser extent) in practical terms of the degree of communication between the major ex-colonial areas of the continent. If Nigeria's accession does no more than break the neo-colonial barrier in the earlier attitudes of the Commonwealth African governments, it will have done a great deal.'⁽²⁾

(1) Pierre Uri (ed.), From Commonwealth to Common Market, Dennis Austin, Britain, Commonwealth Africa and the EEC, Harmondsworth, Penguin, 1968, p.146.

(2) Pierre Uri (ed.), From Commonwealth to Common Market, p.158.

Kenya, Tanzania, Uganda. Following the precedent established by Nigeria, it was easier for the three East African territories to become associates. The Arusha Convention of 1968 was also a departure from a non-discriminatory policy. These countries received preferential treatment in British markets but did not grant reciprocal preferences to British goods. The reason for this was the Congo Basin Treaties of 1885 and 1890, which established the 'Open Door Policy' in the 'Conventional Basin of the Congo' which extends over the East African states.⁽¹⁾ Having acquired independence, however, the East African nations were legally free to alter their commercial policies, since they could not be bound by agreements taken on their behalf by European countries. It was, however, understandably irksome for Britain to see first Nigeria, then East Africa, give to the EEC a preferential treatment which Britain had never received. But Britain was not in a position to complain since she was herself contemplating entry into the Common Market.

Kenya, Tanzania and Uganda formed the East African Common Market in 1967, but so far,

'practically none of the requirements of a true common market is fulfilled. Yet, the East African Common Market must not be judged as it stands to-day but be seen as it will develop in the long run when the transfer tax and other hampering devices have fulfilled their function of removing existing industrial imbalances.'⁽²⁾

Talks between the EEC and East African states started in 1963, but almost collapsed in 1966 over disagreement on coffee quotas

(1) See J. Matthews, Free Trade and the Congo Basin Treaties, S.A. Journal of Economics, vol.27, no.4, December 1959, pp.293-300.

(2) Ingrid Doimi di Delupis, The East African Community and Common Market, London, Longman, 1970. p. 160.
The transfer tax is summarized as follows: 'A State which has a trade deficit in its total trade with the other two Partner States may impose transfer tax on manufactured goods originating from the two other States.' *ibid*, p.83.

and the notion of 'reciprocal preferences'. However, negotiations were reopened, and a final agreement was signed in July 1968. This particular Convention was not ratified but was renewed in 1969, and is now in operation (Arusha Convention).

The reasons underlying the association agreement between the EEC and East Africa are similar to those of the Nigerian agreement, namely the need to protect these countries' external trade, not only from the consequences of a possible British membership of the Common Market, but also from the results of existing association agreements with countries producing goods similar to those of Kenya, Tanzania and Uganda.

It is interesting to note that, since the enlargement of the Community, Britain will receive preferential treatment from Nigeria and East Africa, for the first time.

Malta and Cyprus. The Association agreement between Malta and the EEC (1970) and the agreement with Cyprus (1972) were mentioned in the last chapter. As these countries gave preferential treatment to Britain as members of the Commonwealth, these agreements will simply extend these preferences to other members of the enlarged Community.

Mauritius. The seventh Commonwealth country to become associated with the Common Market is the island of Mauritius. Similarly to the agreements with Malta and Cyprus, this arrangement will eventually give EEC goods the same preferential treatment given to Commonwealth members. The difference is that Mauritius adhered to the Yaounde Convention instead of entering into a sui generis agreement. The links between the EEC and Mauritius will thus be closer than between the Community and the other Commonwealth associates.

The 'associables'. During the negotiations concerning Britain's entry into the EEC, it was decided to offer developing Commonwealth nations some form of relationship with the enlarged Community. These countries, which have become known as 'the associables', are Botswana, Gambia, Ghana, Lesotho, Malawi, Swaziland, Nigeria, Sierra Leone, Zambia, Barbados, Guyana, Jamaica, Trinidad and Tobago, Tonga, Western Samoa and Fiji.⁽¹⁾

These sixteen nations have three choices: an association such as under the Yaounde agreement, a special or partial association such as the Arusha arrangement, or a trade agreement. Negotiations are being carried out at the time of writing, and it is not yet known what the outcome will be. Some 'associables', such as Nigeria, fear that the Association will lead to a subordinate status for the associates. Others reject the proposition of giving preferences to the EEC, which would be the result of a free trade area between the 'associables' and the Community. As for a trade agreement, the GATT rule which expects concessions in tariff matters to be extended to all members of the GATT, is a drawback. Moreover, the political implications of closer links with the EEC are complicating the issue, and several countries uphold the Generalized Scheme of Preferences as being preferable to the trade provisions of an association agreement.

Nevertheless, it is probably that some arrangement will link those Commonwealth developing countries to the enlarged Community, even though the form it will take is as yet unformulated. The Association system has therefore a considerable impact on the trade policies of developing Commonwealth countries.

(1) The Economist, London. 31 March 1973. p.52.

CHAPTER VTRADE BETWEEN THE EEC AND THE ASSOCIATES

Fear of trade loss by non-associates - trade between the EEC and associates - comparison with selected African countries - with developing countries in other parts of the world.

We have seen that the establishment of the EEC Association system aroused criticism from both developed and developing countries.⁽¹⁾ One of the most important arguments put forward at the time was that the Association would cause trade diversion from non-associates to associates and would therefore damage the external trade of developing countries not parties to the agreements.

The purpose of this chapter is to consider the impact of the Association system on the trade of the associated countries and to assess the value of the argument that the trade of non-associates would consequently suffer. The discussion of EEC trade with associates will be conducted under three headings: comparison with non-associated African countries, comparison with developing countries in other parts of the world, and finally, EEC trade with associates as a percentage of world trade.

Statistics were selected from two sources. Figures comparing EEC trade with associates and with other African countries were unfortunately only available up to 1969. The following section, however, - and the most important one - comparing EEC trade with associates and with developing countries in other parts of the world go up to 1971.

(1) See pp. 84-87.

A. COMPARISON WITH SELECTED AFRICAN COUNTRIES.

Tables 2 to 5 show trade figures for the period 1958 to 1969, except where otherwise indicated. Trade between the EEC and the AAMS is compared to the trade between the EEC and Commonwealth African countries of similar economic structure. For further interest, the trade of three developed countries - Britain, the United States and Japan - with those same territories is also shown. In addition to the trade of the AAMS as a group, the figures for two members of this group have been added, namely Zaïre (formerly Congo-Kinshasa) and Madagascar (the Malagasy Republic).

Figures for EEC trade in 1970 are mentioned in the tables, but not used for comparison purposes, because no 1970 figures were available from the same source, for the other countries. The three East African territories are not considered as associates in these tables, since the Arusha Convention between the EEC and Kenya, Tanzania and Uganda was not put into effect until 1971.

Caution must be exercised when considering percentage increases and decreases, because in some cases the changes recorded do not always occur at a regular rate for the period under review. For instance, EEC imports from Madagascar dropped from about 70 million dollars in 1958 to 48 million in 1967, then slowly recovered to approximately 64 million in 1970. However, if the years 1959 and 1970 had been selected, they would have shown an increase (from 56 to 64 million dollars) instead of a decrease of 24% as shown in table 2. To take another example, British exports to Ghana increased from 97 to 138 million dollars between 1958 and 1961, then dropped to 88 million in 1969. Thus a comparison between the years 1961 and 1969 would have shown a much greater decrease than the 9,8% shown

in table 5. In most other cases, however, the changes calculated are a fair reflection of the trend in the external trade of those countries.

(1) Imports

EEC imports from associates and other African areas are shown in table 2. In the period 1958 - 1969, purchases rose by 87,8% from the AAMS as a whole; they increased by 127,6% from Zaïre but decreased by 24% from Madagascar. Figures for EEC imports from Commonwealth African countries show uneven results: an increase of 170,6% from Nigeria and very little change as far as Ghana and East African countries are concerned.

Trade figures for the United Kingdom show that although - in absolute terms - Britain imports more from East Africa than from the AAMS, the percentage increase was much greater for the AAMS than for Commonwealth African countries. The largest increase in imports by the United States was from Nigeria (217,3%) and Japan's imports increased by large amounts from all selected countries and especially from Ghana and Zaïre.

(2) Exports

For the period 1958 - 1969, EEC exports to the AAMS increased by 56,9%, a smaller increase than in the case of EEC imports from those countries. (However, we shall see in tables 6 and 7 that for the period 1958 - 1971, EEC exports to the AAMS have increased by a greater percentage than EEC imports from the AAMS). In absolute terms, EEC exports to associates were about 1 116 million dollars during 1969 whereas imports from the AAMS into the EEC totalled 1 717 million dollars during that year.

EEC exports to non-associated African countries, East Africa and Nigeria, increased by 141,9% and 114,7% respectively, considerably more than for either Zaïre or Madagascar.

TABLE 2

Imports from associated countries (in \$ 1 000)

Into	<u>EEC</u>	<u>A.A.M.S.</u>	<u>Zaire</u>	<u>Madagascar</u>
1958		914 397	279 217	70 833
1969		1 717 639	635 413	53 850
1970		1 862 335	710 186	64 730
change (1958-69) ⁽¹⁾		+ 803 242	+ 356 196	- 16 983
%		+ 87,8	+ 127,6	- 24,0
 <u>UK</u>				
1958		24 500	9 500	2 000
1969		130 779	54 801	4 122
change		+ 106 279	+ 45 301	+ 2 122
%		+ 433,8	+ 476,9	+ 106,1
 <u>USA</u>				
1958		152 400	95 500	16 800
1969		173 113	34 900	27 784
change		+ 20 713	- 60 600	+ 10 984
%		+ 13,6	- 63,5	+ 65,4
 <u>JAPAN</u>				
1958		11 596	726	300
1969		77 354	33 227	3 940
change		+ 65 758	+ 32 501	+ 3 640
%		+ 567,1	+ 4476,7	+ 121,3

(1) The 1970 figure is included for information. The % change, however, is calculated for the period 1958-69, because at the time of writing, no later figure was available for the other countries. Similarly for tables 3, 4 and 5.

Source (tables 2 - 5): Informations statistiques sur l'évolution des échanges commerciaux des E.A.M.A., des Etats associés de l'Afrique de l'est et des pays du Commonwealth de structure comparable. Commission des Communautés européennes, Direction générale de l'aide au développement. Bruxelles, Juin 1971. pp.15, 16, 21, 22, 24, 25, 30, 31, 33, 34, 39 and 40.

TABLE 3

Imports from African Commonwealth countries (in \$ 1 000)

Into		<u>East Africa</u> ⁽¹⁾	<u>Ghana</u>	<u>Nigeria</u>
	<u>EEC</u>			
	1958	79 252(1961)	97 351	114 329
	1969	84 992	94 552	309 415
	1970	96 740	87 751	499 002
	change (1958-69)	+ 5 740	- 2 799	+ 195 086
	%	+ 7,2	- 2,9	+ 170,6
	<u>UK</u>			
	1958	114 542(1963)	64 900	223 700
	1969	161 077	103 922	250 760
	change	+ 46 535	+ 39 022	+ 27 060
	%	+ 40,6	+ 60,1	+ 12,1
	<u>USA</u>			
	1958	84 754 (1964)	63 100	22 300
	1969	78 027	68 524	70 756
	change	- 6 727	+ 5 424	+ 48 456
	%	- 7,9	+ 8,6	+ 217,3
	<u>JAPAN</u>			
	1958	13 482(1962)	800	3 300
	1969	45 433	41 734	12 948
	change	+ 31 951	+ 40 934	+ 9 648
	%	+ 237,0	+ 5116,8	+ 292,4

(1) Kenya, Tanzania, Uganda.

TABLE 4

Exports to associated countries (in \$ 1 000)

From	<u>A.A.M.S.</u>	<u>Zaïre</u>	<u>Madagascar</u>
<u>EEC</u>			
1958	711 828	178 846	75 698
1969	1 116 913	214 618	105 602
1970	1 264 933	263 370	117 137
change (1958-69)	+ 405 085	+ 35 772	+ 29 904
%	+ 56,9	+ 20	+ 39,5
<u>UK</u>			
1958	46 900	24 100	2 100
1969	74 074	26 943	2 266
change	+ 27 174	+ 2 843	+ 166
%	+ 57,9	+ 11,8	+ 7,9
<u>USA</u>			
1958	68 600	39 200	2 800
1969	123 781	42 817	11 915
change	+ 55 181	+ 3 617	+ 9 115
%	+ 80,4	+ 9,2	+ 325,5
<u>JAPAN</u>			
1958	6 100	3 100	2 200
1969	77 934	38 394	6 194
change	+ 71 834	+ 35 294	+ 3 994
%	+ 1 177,6	+ 1 138,5	+ 181,5

TABLE 5

Exports to African Commonwealth countries (in \$ 1 000)

	<u>East Africa</u>	<u>Ghana</u>	<u>Nigeria</u>
<u>From</u>			
<u>EEC</u>			
1958	48 733 (1961)	38 700	72 275
1969	117 869	65 176	155 174
1970	148 173	80 975	224 895
change (1958-69)	+ 69 136	+ 26 476	+ 82 899
%	+ 141,9	+ 68,4	+ 114,7
<u>UK</u>			
1958	126 289 (1963)	97 700	190 100
1969	185 211	88 164	173 519
change	+ 58 922	- 9 536	- 16 581
%	+ 46,7	- 9,8	- 8,7
<u>USA</u>			
1958	21 989 (1964)	10 500	23 200
1969	32 539	62 068	72 118
change	+ 10 550	+ 51 568	+ 48 918
%	+ 48,0	+ 491,1	+ 210,9
<u>JAPAN</u>			
1958	43 105 (1962)	16 900	48 800
1969	57 254	22 734	28 620
change	+ 14 149	+ 5 834	- 20 180
%	+ 32,8	+ 34,5	- 41,4

Considering the trade figures for the selected developed countries, Britain's exports to the AAMS increased by 57,9% and decreased by 9,8% and 8,7% for Ghana and Nigeria respectively, although this may be a temporary setback as mentioned above. Japan's exports to AAMS increased considerably but exports to Nigeria decreased by 41,4%.

It appears therefore, that the establishment of the Association system did not significantly alter patterns of trade in African countries in the first eleven years of the Association.

B. COMPARISON WITH OTHER DEVELOPING COUNTRIES

Tables 6 and 7 show figures of EEC trade with the AAMS compared with EEC trade with other developing countries, not only in Africa but also in other parts of the world. The period under review is 1958 - 1971.

(1) Imports

Figures in table 6 show that between 1958 and 1971, EEC imports from the AAMS did not keep pace with imports from developing areas as a whole (79,2% compared with 158,9%).⁽¹⁾ This is also less than the increase in total imports for that period (328,2%).

It is of interest to note that the largest increase in imports from developing areas originate from 'other African countries'. The cause of this is that EEC imports of oil from Libya increased the total EEC imports from that group, from 8 to 1 784 million dollars between 1958 and 1971. In 1971, Libyan exports accounted for more than half of the total of 'other African countries'.

(1) See also Fig.13, p.111.

TABLE 6

	<u>EEC imports from developing areas</u>		(million dollars)	
<u>From:</u>	<u>1958</u>	<u>1971</u> ⁽¹⁾	<u>change</u>	<u>%</u>
A.A.M.S.	914	1 638	+ 724	+ 79,2
Overseas Territ. (2)	159	330	+ 171	+ 107,6
Maghreb countries (3)	919	1 135	+ 216	+ 23,5
Other African countries	602	3 673	+ 3 071	+ 510,1
Latin American countries	1 647	3 470	+ 1 823	+ 110,7
Asian countries	1 803	5 630	+ 3 827	+ 212,3
Others	779	1 791	+ 1 012	+ 129,9
Total developing countries	6 823	17 667	+ 10 844	+ 158,9
Extra EEC	16 156	49 130	+ 32 974	+ 204,1
Intra EEC	6 790	49 117	+ 42 327	+ 623,4
TOTAL	22 946	98 247	+ 75 301	+ 328,2

(1) Since the 1972 values are expressed in a different unit of account (fine gold) which alters the conversion rate for different countries, and the composition of the groups of countries has also been altered, the 1971 values are the latest suitable figures for comparison purposes.

(2) Overseas dependencies and associates of the EEC (under Part IV of the Rome Treaty); including Surinam and Netherlands Antilles since 1.1.63; excluding Western New Guinea since 1.1.63.

(3) Morocco, Algeria, Tunisia.

Source: Foreign Trade; monthly statistics, Office Statistique des Communautés Européennes, Centre Louvigny, Luxembourg. 1972, No.2. p.12.

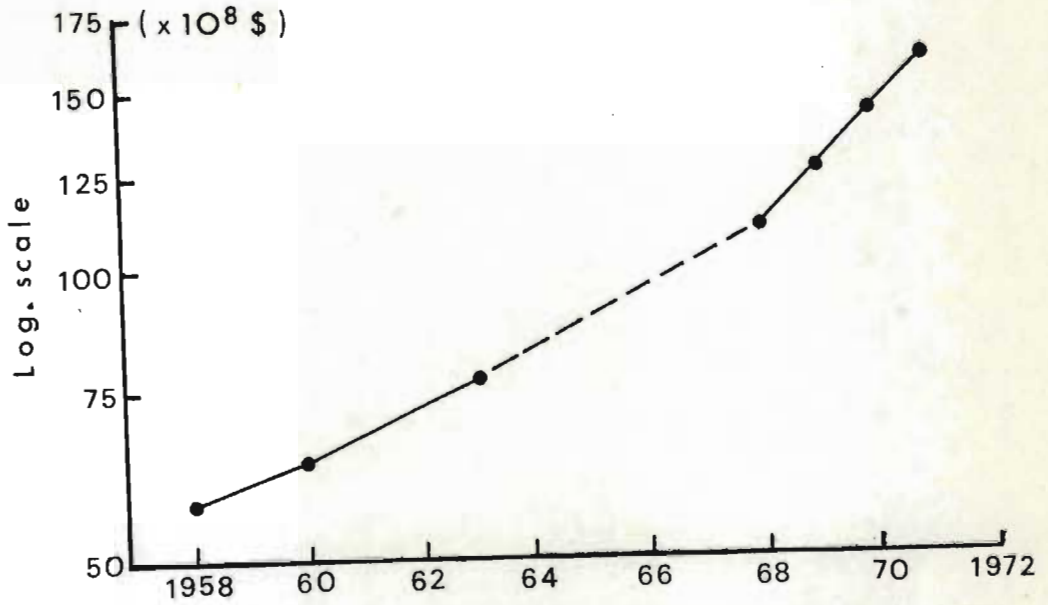


Fig.13a: EEC imports from developing countries other than AAMS and overseas territories

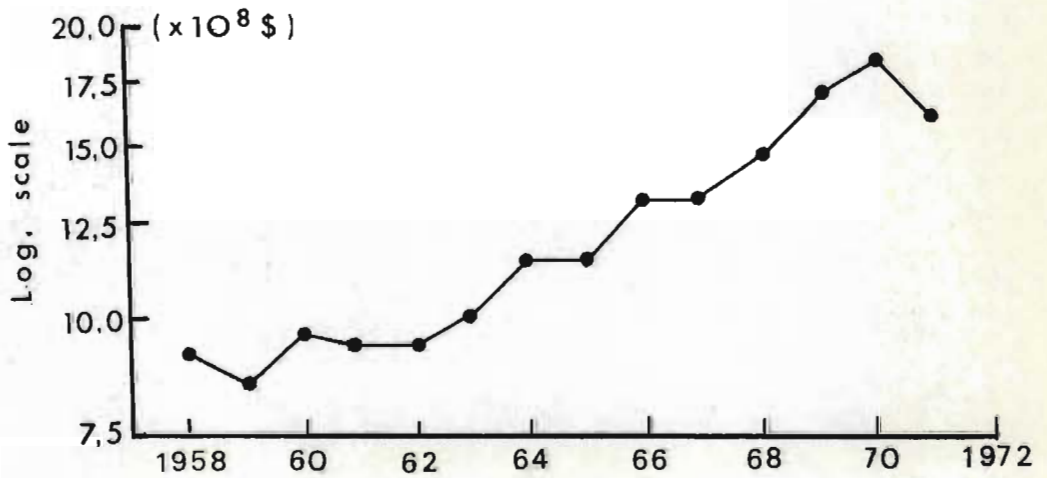


Fig.13a: EEC imports from AAMS

Source: (For Figs. 13a & 13b). Foreign Trade, monthly statistics,, 1972, no.2, p.12.

(2) Exports

Table 7 shows that between 1958 - 1971, EEC exports to the AAMS almost doubled, but increased by 251% to other African countries and by 110,5% to developing areas generally. This is less than the total increase in exports (338,5%), and also less than for the small group of 'Overseas territories' (342,3%).

The only decrease is for EEC exports to North African countries. This is due to a sharp drop in exports to Algeria - from 1 130 to 585 million dollars between 1960 and 1963, recovering to 788 by 1971 - following the emigration of large numbers of Europeans from Algeria in 1962-3.

It is of interest to calculate the AAMS trade as a percentage of trade with developing countries generally, on the basis of figures in tables 6 and 7. In 1958, EEC imports from the AAMS were 13,4% of the total imports from developing areas, and by 1971, they had dropped to 9,3% of the total. The decrease is smaller for exports to the AAMS: in 1958, EEC exports to AAMS were 11,6% of all exports to developing areas, and in 1971, 10,9%.

Moreover, it has been calculated that for the period 1958 - 1971, EEC imports from the AAMS have grown at a rate of 6,2% a year, which is lower than the EEC imports from all developing countries (7,7%) during the same period; but if oil is excluded, the average annual rate of expansion of EEC imports from the AAMS (6,2%) is slightly higher than that of EEC imports from all developing countries (5,5%).⁽¹⁾

(1) Memorandum of the Commission to the Council on the future relations between the Community, the present AASM states and the countries in Africa ... Luxembourg, 4th April 1973. Commission of the European Communities. COM(73) 500/fin. pp. 10 - 11.

TABLE 7EEC exports to developing areas (million dollars)

	<u>1958</u>	<u>1971</u>	<u>change</u>	<u>%</u>
A.A.M.S.	712	1 401	+ 689	+ 96,8
Overseas Territ.	137	606	+ 469	+ 342,3
Maghreb	1 393	1 345	- 48	- 3,5
Other African countries	559	1 962	+ 1 403	+ 251,0
Latin American countries	1 604	3 293	+ 1 689	+ 105,3
Asian countries	693	2 167	+ 1 474	+ 212,7
Others	1 027	2 120	+ 1 093	+ 106,4
Total developing countries	6 125	12 894	+ 6 769	+ 110,5
<hr/>				
Extra EEC	15 911	50 643	+ 34 732	+ 218,3
TOTAL	22 775	99 860	+ 77 085	+ 338,5
<hr/>				

Source: Foreign Trade, Monthly Statistics, *ibid.*, p.14.

TABLE 8

Trade with the A.A.M.S. as a percentage of world trade

(1 000 dollars)

(a) Imports

		<u>from AAMS</u>	<u>from world</u>	<u>%</u>
<u>EEC</u>	1958	914	22 946 ⁽¹⁾	3,98
	1969	1 718	75 594	2,27
<u>UK</u>	1958	25	10 583	0,24
	1969	131	19 956	0,66
<u>USA</u>	1958	152	12 734	1,19
	1969	173	36 052	0,48
<u>JAPAN</u>	1958	12	3 033	0,40
	1969	77	15 024	0,51

(b) Exports

		<u>to AAMS</u>	<u>to world</u>	<u>%</u>
<u>EEC</u>	1958	712	22 775 ⁽¹⁾	3,13
	1969	1 117	75 691	1,48
<u>UK</u>	1958	47	9 395	0,50
	1969	74	16 894	0,44
<u>USA</u>	1958	69	17 875	0,39
	1969	124	37 444	0,33
<u>JAPAN</u>	1958	6	2 877	0,21
	1969	78	15 990	0,49

(1) Total intra-EEC and extra-EEC

Source: As for tables 2 - 5.

C. COMPARISON WITH WORLD TRADE

Table 8 shows EEC trade with the associated African and Malagasy states as a percentage of world trade, compared to trade figures for other developed countries. The latest figures available are for 1969.

(1) Imports

The results are disappointing for the AAMS: as a percentage of world trade, purchases from the AAMS have decreased for the EEC and the United States. They have increased minimally for Britain and Japan.

(2) Exports

Although sales to the AAMS have increased in absolute terms, as a percentage of world trade they have decreased for three of the selected areas. This shows that the purchasing power of the AAMS has not kept pace with the purchasing power of the rest of the world.

D. CONCLUSION

This review of EEC trade with developing countries indicates that in the first eleven years of the Association system there has been no significant trade-diversion from non-associates to associates. The fear of trade loss by non-associates is therefore unfounded for the period under review. On the other hand, it is understandable that the associates are disappointed by the results of the trade arrangements of the system.

At first sight, it would appear that this proves the validity of customs union theory which lays down that the benefits of economic integration are likely to be greater (i) if the economies of the partner countries are actually very competitive but potentially very complementary, and (ii) if the amount of trade between them represents a large proportion of their total external trade.⁽¹⁾

Neither of these propositions hold in the case of the Association system. The products of the EEC and of the associates are complementary, not competitive, except in a few cases such as fruit, which is excluded from the preferential arrangements. Hence, the elimination of tariffs is unlikely to create new areas of specialisation. The proportion of trade between the two groups compared to their total world trade differs; in other words, the bulk of the associates' trade is with the EEC but the share of the EEC trade with associates is small compared with the total external trade of the Common Market.

It would seem therefore, that according to theory, the actual conditions of the Association system are unlikely to lead to benefits for the countries involved. It would be unwise however, to draw such a conclusion, for the following reasons:-

1) Before the establishment of the Association, the associates were already in a preferential arrangement with their Metropolitan countries, and in fact, the preferences they received were greater than those given subsequently by the Common Market. For example, in the case of France and her overseas areas, who form

(1) See Page 39.

the main group of associates, the French customs tariff was higher than the common external tariff applied by the EEC after integration.⁽¹⁾ The associates did not move from a position of free trade to a regional arrangement with the EEC but from one preferential agreement to another. The difference was that the associates exchanged a higher degree of preference in the French market for a lower degree of preference in the wider EEC market.

2) To suggest that if the conditions mentioned above, (i) and (ii), are not present, the countries concerned should not integrate, is tantamount to suggesting that the EEC and the ex-colonies of some of the members would benefit by applying to each other the same tariffs as they apply to others. This would be difficult to accept, when developing countries all over the world are asking developed countries to grant them tariff concessions. Where associates need to impose customs duties in special circumstances, for revenue or protection purposes, the agreements allow them to do so.

3) The theory of customs unions, as the name implies, concentrates on effects of customs unions, where a common external tariff is applied, and only marginally on the effects of free trade areas, where the members are free to impose whatever tariffs they wish on imports from third countries. Most association and trade

(1) Weighted averages: all items: French tariff (1957): 8,1.
EEC tariff (1960): 4,8.
Weighted averages: preference items: French tariff (1957): 8,7.
EEC tariff (1960): 5,1.

P. Robson (ed.) International Economic Integration, (R. Lawrence, Primary products, preferences and economic welfare: the EEC and Africa), Harmondsworth, Penguin, 1972, p. 366, Table 1.

agreements establish free trade areas and not customs unions.

4) Contributions to the extension of customs union theory to developing countries do not really apply to the Association system since they usually investigate integration amongst developing countries and not between developed and developing areas. Some of the associates have integrated among themselves (the East African associates, the UDEAC countries), but these arrangements do not form part of the Association and are, therefore, outside the scope of this study.

It follows that the customs union theory does not explain the lack of change in the trade patterns of associates, and the question does arise as to what is the cause of this situation.

Four factors contributing to this situation are:

1) The Association is fairly recent and trade liberalisation between the European Community and associates was only completed in 1968. Thus it may still be too early to notice any significant effect.

2) Only one-third of the exports of associates are eligible for preferential treatment in the EEC, since the following products enter the Common Market free of tariff, whatever their country of origin: calcium phosphate, gum arabic, ores, crude oil, rubber, raw hides and skins, wood, cotton, sisal, copper, tin, cobalt, tea, seeds and oleaginous fruits.⁽¹⁾

(1) Commission of the European Communities, COM(73) 500/fin. Luxembourg, 4th April 1973. Memorandum ... on the future relations between the Community, the present AASM states and the countries in Africa ... p. 10.

3) The margin of preference given to products from associates has been gradually reduced by world-wide lowering of tariffs in conferences of the GATT.

4) Tariff preferences amount to a price advantage, and are not sufficient for an improvement in trade unless they are combined with an increase in production of suitable goods. Unfortunately, the AAMS - and many other developing countries - still export mainly primary products of low price-elasticity of demand.

In an analysis of EEC trade with associates⁽¹⁾, R. Lawrence concludes that the association arrangements have not had a significant effect on world trade patterns, and he points out that two aspects of the EEC's policies have contributed to this outcome: the reduced preference for some important associate exports (compared to before 1963) and the substitution of capital flows for price-support schemes.

It is also worth mentioning that, although Lawrence refers to the fact that the associates exchanged a higher degree of preference with their ex-Metropolis for a lower preference in the larger EEC, he does not explain that the choice facing the associates was not the old arrangement or the new one, but rather Association or isolation. The Treaty of Rome did not permit the continuation of preferential arrangements with individual members of the Common Market.

One must agree with Lawrence that the trade of the associates has not greatly improved, and has likewise not caused

(1) R. Lawrence: 'Primary products, preference and economic welfare: The EEC and Africa,' from P. Kenen and R. Lawrence (eds.), The Open Economy, Columbia University Press, 1968, pp. 240-260.

damage to the EEC trade with non-associates. Nevertheless, the Association has led to two important changes:-

1) The trade of associates with the EEC as a whole has not altered, but the trade with individual members of the Community has changed. Members of the EEC who in the past had no special relations with associates have increased their imports from them at a higher rate than the other members, and similarly, members without special relations with associates increased their exports to them at a higher annual rate. This is indicated in Table 9.

TABLE 9

Annual growth rate of trade between
EEC countries and associates (1958-1971) (1)

	<u>Imports from associates</u>	<u>Exports to associates</u>
Netherlands	10,7%	11,2%
Germany	11,2%	11,9%
Italy	12,6%	14,7%
France	3,1%	5,1%
Belgium-Luxemburg	6,8%	4,6%

This shows that the Association, by enlarging the preferential area linked with the associates, has caused an important geographical diversification of both imports and exports of

(1) EEC. Commission of the European Communities, COM(73) 500/fin.
Luxemburg, 4th April 1973. Memorandum ... on the future relations ... p. 11.

associated countries, which in itself must be considered as a benefit to those countries. Thus, the only noticeable trade-diversion - though not strictly in the Vinerian sense of the term - has been from ex-Metropolitan countries to other EEC members, and not from non-associates to associates.

2) The other change brought about by the Association system has been the reaction of other countries to this development, which has expressed itself in changes in trade policies, involving a search for similar arrangements with other developed areas, a demand for Generalized Preferences and a rejection of the non-discrimination rule of the GATT. These aspects will be discussed in later chapters of this thesis.

It is sometimes alleged that the Association was formed for the benefit of the EEC. However, there is no evidence that the Common Market has greatly benefitted from the system by expanding exports to the AAMS. The increase in exports to the associates (96,8%) has been less than the increase in exports to developing countries as a whole (110,5%). It is true, however, that the increase in EEC exports to associates is higher than the increase of EEC imports from AAMS for the same period (79,2%), but this may be due to a higher growth rate in the EEC compared to the AAMS (see Tables 6 and 7).

In a recent article studying the effects of the Association on EEC trade, it is concluded that

'The association arrangement seems to have resulted in trade-diversion, particularly against non-associated

less-developed countries whose export products are competitive with those of the Associated African countries.'⁽¹⁾

However, this conclusion is based on trade percentages and not on absolute figures,⁽²⁾ and therefore, only shows that in some cases, the share of non-associates' exports to the EEC has declined compared to the share of associates' exports to the EEC. This is not trade-diversion in the Vinerian sense. To illustrate this point, suppose countries A and B each export 100 units of goods to X. Thus, their share of X's total imports is 50% each. Now suppose that in the following ten-year period, A's exports increase to 200 units, whilst B's exports remain at 100 units. B's share is now 1/3, whilst A's share has risen to 2/3 of the total. However, none of B's trade has been diverted, since X still imports 100 units from B. The only change has been an increase in A's exports to X, and consequently one cannot conclude that this has been trade-diversion from B to A.

Finally, it should be remembered that among writings extending the field of customs union theory to factors other than production and consumption effects, there is a gradual acceptance that customs unions and similar arrangements are entered into, not only for economic reasons but also for non-economic reasons. This is the background of the Association system which attempts to maintain existing links between ex-colonies and European countries.

(1) Alassane D. Ouattara, Trade effects of the Association of African countries with the European Economic Community, International Monetary Fund, Staff Papers, vol. XX, July 1973, No.2, pp.499-543. (This article contains valuable statistical data, but unfortunately only up to 1968).

(2) Alassane D. Ouattara, Trade effects p. 512, Table 5.

CHAPTER VIIMPACT OF THE ASSOCIATION SYSTEM ON SOUTH AFRICA

Changes in South Africa's pattern of trade - effects of British entry into the EEC - on Common Market countries - on the Commonwealth - on the Republic of South Africa - prospect of an agreement between South Africa and the EEC - the South African Customs Union.

In Chapters III and IV, it was shown that the Association system of the European Economic Community has had an important impact on African trade policies. All francophone countries (except Guinea) are associates of the Common Market, several anglophone nations have become partial associates and the remaining Commonwealth African countries are negotiating towards some form of relationship with the Community, following the entry of Britain into the EEC.

To complete this survey of the effect of the Association system on Africa, it is important to consider the most developed area of this continent, the Republic of South Africa. The Association affects the commercial policies of South Africa in two ways: first, it offers the possibility of an agreement between the Republic and the enlarged Community, which would mitigate the detrimental effects of the loss of tariff preferences due to Britain's entry into the Common Market, and second, it acts upon the South African Customs Union which includes three 'associable' Commonwealth countries.⁽¹⁾

(1) Countries which have been offered association with the enlarged Community.

These aspects will be considered in the context of South Africa's trade with Britain and the EEC. This chapter will be divided into four parts: an examination of changes in the pattern of South Africa's external trade with Britain and the Community, the effects of Britain's entry into the Common Market, prospect of an agreement between South Africa and the EEC and finally, the impact of the Association on the South African Customs Union.

A. CHANGES IN SOUTH AFRICA'S PATTERN OF TRADE

Table 10 shows South Africa's trade with the EEC, United Kingdom, United States and Japan, as percentages of the Republic's total trade. The years 1958 and 1969 represent trade before and after the establishment of the Common Market since the Six took ten and a half years to abolish tariffs between themselves.

TABLE 10
Percentage of South Africa's trade with selected countries⁽¹⁾

	<u>South Africa's imports from</u>					
	<u>EEC</u>	<u>UK</u>	<u>USA</u>	<u>JAPAN</u>	<u>OTHERS</u>	<u>TOTAL</u>
	%	%	%	%	%	%
1958	18,1	33,7	17,5	2,6	28,1	100,0
1969	23,7	23,7	17,4	8,8	26,4	100,0
1970	25,8	22,1	16,7	8,7	26,7	100,0
1971	24,7	23,2	16,3	10,1	25,7	100,0
1972	24,8	20,9	16,5	9,4	28,4	100,0
	<u>South Africa's exports to</u>					
	<u>EEC</u>	<u>UK</u>	<u>USA</u>	<u>JAPAN</u>	<u>OTHERS</u>	<u>TOTAL</u>
	%	%	%	%	%	%
1958	17,1	29,8	7,1	1,4	44,6	100,0
1969	18,6	33,3	7,1	9,9	31,1	100,0
1970	18,1	29,1	8,3	11,7	32,8	100,0
1971	17,7	26,7	7,7	11,6	36,3	100,0
1972	19,6	26,0	7,2	12,7	34,5	100,0

Source: Department of Statistics, Republic of South Africa, South African Statistics, Pretoria.

(1) 'South Africa' includes South-West Africa, Botswana, Swaziland and Lesotho.

A comparison between the respective percentages of the EEC and Britain between 1958 and 1972 shows the following changes. For both imports and exports, the share of the EEC has increased and that of Britain, which has always been South Africa's main trading partner, has dropped. Furthermore, a different picture emerges from imports compared with exports. There has been a greater change for imports: South Africa's imports from the EEC increased by 6,7% and imports from Britain decreased by 12,8%. Changes in exports are much less significant (except for Japan): South Africa's exports to the EEC increased by 2,5% during the period under review, while South Africa's exports to Britain decreased by 3,8%. Thus, although in 1972, South Africa still exported more to Britain than to the Six, she imported more from the EEC than from Britain.

Considering the figures for Japan and the United States, it is interesting to note that South Africa's trade (both imports and exports) increased proportionately far more with Japan than with the other areas, while the share of the United States remained substantially the same.

Although table 10 shows trade percentage with the EEC as a whole, Germany is the main trading partner of South Africa, among the Six. In 1971, Germany absorbed almost half of South Africa's exports to the Common Market (265 out of a total of 549 million dollars) and more than half of South Africa's imports from the EEC come from Western Germany (574 out of a total of 1044 million dollars).⁽¹⁾

Regarding the establishment of the Common Market on South Africa's trade, her exports to the EEC shows a slight increase which may expand in time. The enlargement of the Community, however, will

(1) European Economic Community, European Statistical office, Foreign Trade Statistics, Brussels, 1972, no.2, pp. 34 and 36.

have a dual effect on the trade of the Republic, and the net result will depend on the strength of these divergent trends. South Africa's exports to the Common Market may increase further, if the economy of the Community continues to expand. The enlargement of the group has turned it into the most populated trading group in the world. In 1970, the population of the Nine members totalled 253 millions, compared to the USSR (243 millions) and the United States (205 millions).⁽¹⁾ On the other hand, British membership of the EEC may lead to a reduction in South Africa's exports to Britain, because South Africa will lose the tariff preferences from which her exports have benefitted in the past. This aspect will now be considered in detail.

B. EFFECTS OF BRITAIN'S ENTRY INTO THE EEC

On 1st January, 1973, Britain, Ireland and Denmark became members of the European Community. As part of the process of economic integration, the EEC and these countries will abolish all tariffs between them and the new members will apply the common external tariff (CET) of the EEC on imports from outside the Community.

Britain's entry will affect all her trading partners. It will abolish British tariffs on goods from EEC members, reduce them in some cases on goods from non-EEC countries (where the British most-favoured-nation rate is higher than the CET) but it will increase tariffs on imports from the Commonwealth, since Britain is moving out of the Commonwealth preferential system. These aspects will now be considered in some detail.

The transitional phase is planned to last from 1973 to 1977, during which tariffs will be adjusted between Britain and

(1) Extracted from Basic Statistics of the Community, Luxembourg, Statistical Office of the European Communities, 1971.

other countries as follows:-

1) EEC countries

Tariffs will be abolished between Britain and the EEC according to the following time-table:

1.4.73	cut of 20%	total adjustment: 20%
1.1.74	cut of 20%	total adjustment: 40%
1.1.75	cut of 20%	total adjustment: 60%
1.1.76	cut of 20%	total adjustment: 80%
1.7.77	cut of 20%	total adjustment: 100%

2) Non-EEC countries

Britain will adjust her tariffs to the level of the EEC common external tariff towards all third countries. With a few exceptions, this will be done according to the following time-table:

1.1.74	adjustment of 40%	total adjustment: 40%
1.1.75	adjustment of 20%	total adjustment: 60%
1.1.76	adjustment of 20%	total adjustment: 80%
1.7.77	adjustment of 20%	total adjustment: 100%

The direction of these adjustments will differ according to the level of the British tariff towards each third country prior to enlargement. In this regard, a distinction must be drawn between Commonwealth and non-Commonwealth countries, and between EFTA and non-EFTA countries. The South African situation will be examined separately.

(a) Commonwealth countries:

In most cases, these countries have benefitted from preferential treatment for their exports since the Ottawa conference of 1932. By entering the Common Market, Britain has exchanged Commonwealth preference for Community preference and several tariffs will have to be increased from the preferential level to the external tariff.

The problem of Commonwealth preferences was among the more serious difficulties which had to be solved at the time of the negotiations between the United Kingdom and the EEC. Special arrangements were made in the case of New Zealand butter and Caribbean sugar. Developing Commonwealth nations with an economy similar to those of the EEC associates have been offered association or trade agreements, and negotiations are currently taking place between the EEC and the so-called 'associables'.⁽¹⁾ Trading arrangements are to be made with India and Pakistan and special treatment will be given to products of importance to Ceylon and Hong Kong. (e.g. a nil duty on tea imports).⁽²⁾ Australia and Canada will have to adjust their trade to the new situation, as they were not developing countries in need of special arrangements.

It is probable that better terms would have been given to Commonwealth countries if Britain had joined the EEC in 1957. The association system began as a means to accommodate the special relationship between France and its dependencies, and similar steps could have dealt with the Commonwealth problem. It is not the first time, however, that Commonwealth countries have been at a disadvantage due to changes in the external commercial policies of Britain. The establishment of the European Free Trade Association in 1960 resulted in some cases in the Commonwealth product remaining subject to an import duty - even at a preferential rate - whereas the EFTA product could enter free.⁽³⁾

(b) Non-Commonwealth countries:

Among these, EFTA countries were likely to lose their duty-free entry into Britain unless some arrangements could be made.

(1) See p.101.

(2) Dennis Swann, The economics of the Common Market, second edition, London, Penguin Modern Economics Texts, 1972, p.184.

(3) Commonwealth preference R.5155/69, London, British Information Service, 1969, p.14.

Bilateral agreements between the EEC and those EFTA countries not entering the Common Market have resulted in a 16-nation free trade zone.⁽¹⁾

Non-Commonwealth countries which are not EFTA members will benefit from British entry whenever the rate of the common external tariff of the EEC is lower than the British most-favoured-nation rate, and will face increased tariffs when the opposite is the case.

(c) South Africa:

Although a non-Commonwealth country, the Republic is in a similar position to that of Australia and Canada. The bilateral agreement between Britain and South Africa, signed at Ottawa in 1932, was not conditional on membership of the Commonwealth and therefore was not affected by South Africa leaving the Commonwealth in 1961. Thus the Republic continued to benefit from British preferential tariffs and reciprocally, to grant British goods reduction from the most-favoured-nation rate. Britain's entry into the EEC led to the abrogation of the 1932 agreement earlier this year, and South Africa's exports to Britain will gradually face the higher CET. The first rise in tariffs will take place on 1st January 1974 and by 1st July 1977, the full CET will have to be met.

Misgivings have been expressed about the possible effects of British entry into the Common Market on the South African export sector. It is not the purpose of this work to examine this problem in detail or to suggest means of marketing and export promotion which should be undertaken to minimize the disadvantages of the new situation.⁽²⁾ However, the following points must be made.

(1) - European Community, September 1972, p.11. See also p.186-8 of this thesis.

(2) See inter alia, J.J. Williams, The competitive situation for South Africa. South African Foreign Trade Organisation (SAFTO), 1971, and C.J.A. Wright, The probable effects of Britain's entry into the EEC on the economy of South Africa, The South African Banker, vol. 70, no.2, May 1973, pp. 123-130.

Together with other countries - Australia, Brazil, Canada, Japan and New Zealand - South Africa is at present negotiating under Article XXIV (section 6) of the GATT, for compensation for trade losses resulting from the enlargement of the EEC. This rule provides for compensation for third countries which have lost trading advantages due to the creation or enlargement of customs unions and other forms of economic integration, which is allowed under Article XXIV of the GATT. These compensations usually take the form of tariff concessions, but not necessarily in the same product as those affected by the change. At the time of writing, no details are yet available on the progress of South Africa's request.

Any evaluation of the effects of British entry on South African exports must differentiate between industrial and agricultural exports. Industrial tariffs of the EEC are generally lower than those of most other developed areas. A comparison of industrial tariffs after the Kennedy Round of the GATT (1964-1967) revealed the following figures: ⁽¹⁾

EEC	7,6%	(unweighted averages)
USA	11,2%	
UK (most-favoured-nation)	10,2%	
(preferential)	1,2%	
JAPAN	9,8%	

Thus, although South African industrial exports will face higher tariffs than previously, these are still relatively low.

The prospect is different with regard to South Africa's agricultural exports to Britain. Agriculture in the Common Market is protected by the common agricultural policy (CAP) which results in the application of levies on imports, in order to bring the prices

(1) H.G. Johnson (ed.), New trade strategy for the world economy, London, G. Allen and Unwin, 1969, p.206. These are 'nominal' rates. It has been shown that 'effective' rates of protection are often higher than the 'nominal' rate. See John Pincus, Trade, aid and development, New York, McGraw-Hill, 1967, pp. 189-190.

of imports to the level of domestic imports. In some cases, agricultural imports have to pay the common external tariff as well. The CAP supports high food prices within the Community, to enable persons engaged in the agricultural sector to earn incomes comparable to those in other sectors of the economy.

The South African industries most likely to suffer a setback when Britain increases tariffs to the CET level, are fruit, vegetables and wine. Next to diamonds, this group is the main export to the United Kingdom. Various steps can be taken to minimize the drawbacks, apart from requests for compensation through the GATT, mentioned above. Regarding the wine industry, South African products can avoid paying the full amount of the CET by conforming to the EEC rules of origin ('appellation originée').⁽¹⁾ Fresh fruit and vegetables may be able to benefit from seasonal advantages and it must be remembered that the Republic has an established market for oranges in the Community. Greater efficiency in local industries and improved marketing and advertising may help these industries to retain their present place in the British market.

South Africa may benefit in the long-run from the probable improvement in the British economy due to its membership of the EEC. It is hoped that demand will increase and that British importers will not alter their trade pattern for some time. By then, the Republic may also have expanded its markets in other areas.

The abrogation of the bilateral agreement between South Africa and Britain also affects South African tariffs. The Republic is now free to apply most-favoured-nation rates to imports from the United Kingdom, unless these are 'bound' under the GATT rules. It is not clear, as yet, which goods will be subjected to these increased

(1) This requires specific reference to quality and guaranteed genuineness of product in respect of area, vintage, etc.

rates. South Africa may use this possibility of tariff adjustment as a bargaining tool in future negotiations; for instance, she may offer to maintain a tariff at its present level, if, in exchange, the EEC offers a comparable tariff concession.

Finally, the adverse effects of Britain's entry into the EEC on South African trade must not be exaggerated. The Reynders Commission reported that it was of the opinion that

'South African producers should ... generally have no insurmountable difficulty in competing effectively with other countries in the enlarged EEC provided optimum attention is given to such aspects as research, management, processing and infrastructural facilities'⁽¹⁾

As mentioned earlier the Association affects the Republic in two ways: the prospect of an agreement between South Africa and the EEC, and the effect on the South African Customs Union. These aspects will be considered in turn.

C. PROSPECT OF AN AGREEMENT BETWEEN SOUTH AFRICA AND THE EEC.⁽²⁾

Since South Africa will lose her preferences in the British market when Britain applies the common external tariff of the EEC, it is of interest to investigate the possibility of an association or trade agreement between South Africa and the EEC.⁽³⁾

South Africa is neither a developing country nor a Commonwealth member. Therefore, she has not been offered special arrangements such as was the case for Commonwealth African countries.

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- (1) Republic of South Africa, Report of the Commission of Inquiry into the export trade of the Republic of South Africa, RP 69/72. Government Printer, Pretoria, 1972, p.89.
- (2) See J. Matthews, Prospect of an association agreement between South Africa and the European Economic Community, South African Journal of Economics, vol. 38, no.2, June 1970, pp. 152-162.
- (3) As far as the writer is aware, no information is available on the progress of South Africa's negotiations at the Brussels headquarters of the EEC.

The Yaounde Association is opened to countries 'which have an economic structure and production comparable to those of the Associated States' (Article 58). Obviously, the Republic's industrial development places her in a different category and she does not qualify for full association.

Special association such as offered by Article 238 of the Rome Treaty offers more scope, since it does not limit the possibility of such an arrangement to developing countries, although so far, most partial associates are developing countries. It was shown, in Chapter II that the Association system of the EEC has grown far beyond the original institution which was established primarily to deal with problems of the dependencies of EEC members. It now extends to countries with no historical ties with members of the Community, and includes a variety of special association agreements as well as trade agreements. In addition, the enlargement of the EEC has led to arrangements with countries of the Commonwealth not eligible for association (see p.128) whilst agreements with Israel, Argentina and current negotiations with other nations such as India show that the road is open for arrangements with semi-developed areas or to use a term of the Reynders Commission, 'middle-zone' countries.⁽¹⁾

Although the possibility of an association agreement between South Africa and the EEC cannot be excluded, the real problem lies in the political sphere. Most countries are prepared to trade with South Africa, but they are reluctant to enter into a closer relationship, because of the Republic's policy of apart-

(1) 'South Africa, Canada, Australia and New Zealand claim themselves to be 'middle-zone' countries, i.e. neither fully industrialised nor developing countries, on the grounds that they are still heavily dependent on exports of primary products while importing manufactures for purposes of industrialisation.' (Report of the Commission of Inquiry into the export trade of the Republic of South Africa, p. 60)

heid. African associates, in particular, object strongly to any suggestions that an arrangement could be worked out with South Africa. In this respect, the case of Spain and Portugal is of special interest. For many years, an agreement with those countries seemed impossible due to their undemocratic political systems. Yet, in 1970, a trade agreement was signed with Spain, establishing a customs union with the EEC, and as Portugal is a member of EFTA, she qualified for those trade arrangements which the EEC made with EFTA members following the enlargement of the Community. Thus it must be pointed out that political opinions change and that the possibility of an association agreement must not be rejected out of hand.

Nevertheless, a trade agreement between South Africa and the EEC appears to be the most feasible solution. The Republic may prefer this arrangement to a closer relationship such as an association agreement. It must be borne in mind, however, that under the rules of the GATT, any tariff concession must be extended to all members of the GATT on a most-favoured-nation basis. The Republic could ask for better terms for exports of fruit, vegetables and wine, and offer in exchange tariff concessions on imports of industrial goods from the EEC. South Africa could make use of the bargaining tool mentioned above (see p. 86-7) and offer to maintain the preferential tariffs applied to British goods and extend these, or some of them, to similar products from the whole Community, since the abrogation of the bilateral agreement with Britain leaves South Africa free to adjust those tariffs to the most-favoured-nation rate. Presumably, this move would obtain British support within the EEC, as British exporters would not wish to lose those favourable terms in the South African market.

D. THE SOUTH AFRICAN CUSTOMS UNION

Since 1910, a customs union has existed between South Africa and the three neighbouring territories, now the independent states of Botswana, Swaziland and Lesotho (BSL). The customs revenue is divided according to a specific formula, providing a substantial source of revenue to the smaller territories. It is also a monetary union, since BSL use South African currency.

As members of the Commonwealth and developing countries, BSL are offered a full association with the enlarged Community, a partial form of association or a trade agreement (see p.101). Any of these arrangements would affect the South African Customs Union. The establishment of a free trade area with the EEC, or a trade agreement would have to be done with South African approval, since it would mean changes in the common external tariff of the customs union. Rules of origin would have to be laid down to avoid the import of EEC goods into South Africa through the other members of the customs union and decisions would have to be taken to deal with the problem of re-export by BSL. This is unlikely to be a serious problem however, as Lesotho and Botswana are land-locked countries; only Swaziland offers that possibility, through the port of Lourenço Marques.

South African co-operation in this respect might earn goodwill in trade negotiations with the EEC. It is also possible that BSL might be the 'Trojan horse' and lead the whole Customs Union into the Association system of the EEC, in the same way as EFTA paved the way for Portugal.

Conclusions.

South Africa's pattern of trade is changing. Although Britain remains the main buyer of South African goods, South Africa's trade is increasing with the EEC and decreasing with Britain, and

therefore the Republic might have sought a trade agreement with the Community even if Britain had not entered the EEC. The inclusion of Britain into the Common Market has increased South Africa's chances of concluding an arrangement. At the same time, the loss of preferences in the British market might cause some damage to exports from the Republic but these fears have been overemphasized and 'the Community does not preclude individual negotiations with aggrieved parties who can show that enlargement harms their trade'.⁽¹⁾ A trade agreement between South Africa and the enlarged EEC would bring her into the Association system.

The South African Customs Union will be directly affected by the Association system if the three Commonwealth countries which are also members of the customs union enter into an association or trade agreement with the European Economic Community.

The impact of the Association system of the EEC on international trade policies in Africa is therefore likely to increase in the future, not only for developing Commonwealth countries but also for the Republic of South Africa.

(1) European Community, February 1973, p.12.

CHAPTER VIITHE GENERAL AGREEMENT ON TARIFFS AND TRADE,
AND PREFERENCES

Early views of the GATT on preferences - the principle of non-discrimination - the principle of reciprocity - preferential agreements since 1947 - EEC association and trade agreements - reverse preferences - theoretical aspects - recent evolution of the GATT's views on preferences.

The first part of this thesis examined the Association system of the EEC and the impact of this development on Africa. We shall now consider the influence of the Association system on more general aspects of international economic relations.

This chapter will discuss the position of the GATT towards tariff preferences and more specifically, towards the preference embodied in the EEC association and trade agreements, which have caused, and are still causing, considerable controversy.

The General Agreement on Tariffs and Trade, signed in 1947 by 23 countries, was meant to be an interim measure in the formation of a more ambitious plan, the International Trade Organisation. However, the United States failed to ratify the Havana Charter of the ITO and the scheme was abandoned, leaving the GATT as the only viable undertaking.

The main purpose of the General Agreement, which consists of a set of rules for international trade, is to liberalise trade by a progressive reduction of tariffs. The GATT acts by pressure and persuasion since it has no power of coercion on its members. In the last twenty-five years, sixty countries have

joined the GATT, bringing the total number of Contracting Parties to eighty-three, whilst a few others have acceded provisionally. The GATT headquarters and general secretariat are situated in Geneva, Switzerland, where most of the 'rounds' of negotiations take place, the latest being the Kennedy round.

Article I of the GATT explicitly rejects preferences by declaring that 'trade shall be conducted in a non-discriminatory manner, on the general basis of equality of treatment for all Contracting Parties'.⁽¹⁾ Although exceptions have been allowed, the GATT has on many occasions reaffirmed its belief in its unconditional most-favoured-nation clause, but has been unable to prevent an increase of preferential arrangements.

The GATT considers two types of preferences in tariff matters. One is unilateral, and when tariff concessions are made, the rule is that the preference should be extended to all Contracting Parties. Mutual preferences, on the other hand, are those inherent in the formation of free trade areas or customs unions and are only allowed by the GATT according to the conditions laid down in Article XXIV. One of the conditions is that the reciprocal elimination of tariffs will involve 'substantially all the trade' between members of the free trade area or customs union.⁽²⁾

A consideration of the benefits which tariff preferences may have on the economies of developing countries and on world welfare as a whole, is beyond the scope of this chapter.⁽³⁾ We are only concerned here with the conflict between the Association system and the principles of the GATT, and with the impact of this conflict on the rules of the GATT.

(1) and (2) See Annex D for relevant Articles of the GATT.

(3) The advantages and disadvantages of Generalized Preferences (given by developed countries to manufactured exports from developing countries) will be examined in Chapter VIII.

This chapter will therefore outline the views of the GATT at the signing of the General Agreement in 1947, preferential agreements which have taken place since then, the specific problem of preferences contained in EEC association and trade agreements and finally, some comments on possible changes in the GATT rules on this matter.

A. EARLY VIEWS OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE

During the discussions leading to the establishment of the GATT, two conflicting attitudes towards preferences became evident, as shown in the viewpoints of the United States and Britain. This duality still exists today among the international commercial policies of the GATT members.

The viewpoint of the United States, which was the prime mover of the GATT, was that preferences should be discarded and that trade should be conducted in a non-discriminatory manner. 'The United States had made elimination of all preferences a major principle of its policy for the post-war organisation of world trade. The chief goal of the U.S. policy was elimination of the Imperial preference system established at the Ottawa Conference of 1932.'⁽¹⁾

The United Kingdom, on the other hand, had no wish to dismantle the system of Commonwealth preferences, which had formed part of the British commercial policy for many years. Most countries appeared to align themselves with one or the other viewpoint, not on theoretical grounds, but according to whether they were part of a regional arrangement or not. The Scandinavian countries, which at that time did not belong to any economic regional group, sided with the U.S. point of view, whereas France, as part of the Franc zone whose preferential arrangements go back to 1928, agreed with Britain for the retention of these preferences.

(1) Kenneth W. Dam, The GATT law and international economic organization, Chicago, University of Chicago Press, 1970, p.42.

1) The principle of non-discrimination

The results of the duality of positions on preferences was embodied in Article I which reads:

1. 'With respect of customs duties, any advantage granted by any Contracting Party shall be accorded immediately and unconditionally to the like product originating from all other Contracting Parties.'
2. 'The provisions of paragraph 1 of this article shall not require the elimination of any preferences which fall within the following descriptions:'

There followed a list of existing preferences, listed in adjoining annexes. These included the Commonwealth preferences, those of the French Union, Benelux, etc. These were allowed to remain provided that the margin of preference did not increase.

Thus the first article of the GATT embodied the principle of non-discrimination and the exceptions. It may also be said that Article I included both the theory and the practice, or the ideal and the reality. 'The effect of seeking to outlaw preferences was, ironically enough, to write a permanent exemption into the General Agreement for most existing preferential systems.'⁽¹⁾

It is of interest to note that among the exceptions to the rule were the preferential arrangements between the U.S. and Cuba, and between the U.S. and the Philippines, although the U.S. had an official non-discriminatory commercial policy.

By exempting existing preferences from the rule of non-discrimination, the General Agreement undermined the principle of equality of treatment for all Contracting Parties. Furthermore, by differentiating between preferences existing in 1947, and those which may be set up later, accepting the first and forbidding the others, the Agreement became the defender of the

(1) Kenneth W. Dam, The GATT law....., p.42.

status quo in commercial policies. This was especially a handicap for countries which acquired independence in the years following the establishment of the GATT, a great number of which became parties to the General Agreement. Those countries which did not already belong to a preferential area, and wished to do so, found that this was prohibited by Article I of the GATT.

The view that existing preferences should be allowed to remain, but that new ones should be discouraged, is vulnerable to criticism. If preferences are detrimental to international trade, then those existing in 1947 should have been gradually dismantled over a reasonable period of time.

The exemption for existing preferences is not the only exception to the rule of non-discrimination. It will be shown in Chapter VIII that there are other reasons for the weakness of the GATT's first principle. The only other exception relevant here is Article XXIV, because this was invoked by the EEC in order to enter into association agreements with other countries.

2) The principle of reciprocity

One of the main rules of the GATT is that concessions in tariff and other customs matters should be carried out on a reciprocal and mutually advantageous basis. (Article XXVIII bis). This means that contracting parties need only make concessions when they are offered similar concessions by other members. The expression 'mutually advantageous' is not explicit, and the fact that reciprocity is not defined in the General Agreement leaves the way open for a variety of interpretations.

Although the principle of reciprocity was generally acceptable when the Contracting Parties were mostly developed countries, it soon became evident that it needed revision, when the number of developing members of the GATT increased considerably.

This was done in 1965, when a new chapter was added to the Agreement, to provide for the special requirements of developing members. In this new section of the GATT, Article XXXVI reads: 'The developed Contracting Parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed Contracting Parties.' Thus the GATT rejects 'reverse preferences' from developing to developed countries, because they are thought to be inconsistent with the development needs of those countries. This aspect was one of the reasons for the criticism levelled at some of the EEC Association agreements with developing countries, as discussed below (see p.145).

B. PREFERENTIAL AGREEMENTS SINCE 1947.⁽¹⁾

Before examining the case of the Association system of the European Economic Community, and the infringement of the GATT rules which it is alleged to entail, it is of interest to mention briefly four preferential agreements which were condoned by the GATT, through the granting of a waiver:-

1) As early as 1948, the United States asked the GATT permission to give preferential treatment to imports from Pacific islands under United States Trusteeship.⁽²⁾ The reason offered was that these islands had been under Japanese mandate and had received preferential treatment from Japan, and that duty-free access to the United States market would compensate the islands for the loss of the Japanese preferences and thus help their export earnings and their economic development. Although Japan had reverse preferences in these Pacific islands, the United States

(1) For more details, see Gardner Patterson, Discrimination in International trade, the policy issues, 1945 - 1965, Princeton, Princeton University Press, 1966, Chapter VII.

(2) The Marshall, Caroline and Marianas Islands, except Guam.

did not seek this. The request was granted in the form of a waiver of the United States' non-discriminatory commitments. There was some fear that this would create a dangerous precedent, however, and the Contracting Parties reserved the right to review the situation if injury to the trade of other members ensued from the preferences. It appears that no such request has been made so far, probably because the preferences covered only a small portion of trade, namely coconut oil and copra.

2) The second preferential arrangement allowed by the GATT was that between Italy and Libya in 1951. A waiver was granted to Italy so that she could continue to give preferential treatment to a number of products from Libya. This could be regarded as a technical matter, however, because Libya had received preferential treatment from Italy as a Colony. The change in status brought about by its independence made it necessary for Italy to ask the GATT for a waiver which was duly granted under certain conditions.

3) In 1953, Australia asked for a waiver of its most-favoured-nation obligations in order to grant duty-free entry to goods from the territory of Papua-New Guinea. Reverse preferences were not to be applied, although the possibility of incorporating the area in question into the Australian customs territory was investigated and rejected. Contracting Parties were worried about the fact that the goods subject to preferential treatment were not listed. The main reason for the Australian request was once again that this would help the economic development of Papua-New Guinea and the waiver was granted.

The consequences of these first three preferential agreements condoned by the GATT, was a certain awareness of the need for a change in the GATT rule in order to provide a guiding principle

for similar cases in the future. In 1954, the United Kingdom proposed that a new rule be added to the Agreement to enable metropolitan countries to give preferential treatment to a dependent territory without breaking the GATT rules. This could be done by regarding the territory as being in the same customs area as the Metropolitan country. The Contracting Parties rejected the British proposal, for the following reasons. First, there was the concern of another breach of the non-discriminatory rule, and of the principle that no new preferences should be allowed. This concern was felt by developed countries which at that time enjoyed no preferences but which were soon to form the European Free Trade Association, inter alia Switzerland and Sweden. Secondly, some members feared that this new proposal would threaten their own exports if they did not seek preferences for themselves. Thirdly, there was a fear that it would perpetuate the dependence of the territory on the metropolitan country.

The search for a formula to give preferential treatment to exports from developing countries was to lead, nine years later, to the 'Basseur plan', which suggested the first steps of the Generalized Scheme of Preferences. This will be discussed in the next chapter.

4) A more recent breach of the non-discrimination rule and perhaps the most surprising because it emanated from countries who are both highly developed and who were the most prominent defenders of the GATT rule, was the United States - Canadian Automotive Products agreement of 1965. According to this arrangement, tariffs on most automotive vehicles and original equipment parts were to be eliminated between the two countries. Canada planned to extend this tariff cut to imports from other countries, but the United States had no intention to do likewise. ⁽¹⁾

(1) For more details see Kenneth W. Dam. The GATT law..... pp. 48-50, and Gardner Patterson, Discrimination in International Trade, pp. 356-8.

C. PREFERENCES IN THE EEC ASSOCIATION AND TRADE AGREEMENTS.

From the beginning of the European Economic Community, allegations have been made that rules of the GATT were being infringed. The calculation of the common external tariff was criticised by a Working Party of the GATT because the EEC had decided on an arithmetical average of the tariffs of France, Germany, Italy and Benelux; this system increased tariffs in some cases, and lowered them in others. Although the customs union was permitted by Article XXIV, it was held that the method of calculation contravened the rule that 'the duties shall not on the whole be higher or more restrictive than the general incidence of the duties prior to the formation of such union.'⁽¹⁾ The arithmetic average had the great advantage of being a simple method and in spite of representations by the GATT members, the EEC refused to discuss the best method of calculation, because they maintained that Article XXIV did not demand any special method, and that their method was appropriate. The underlying reason for this refusal was probably the feeling that unless a definite start was made with the customs union, there was a danger of having every step of the process of integration discussed and delayed by the GATT.

Although the economic union planned by the Six was allowed under Article XXIV, even if the legality of the method of calculation of the common tariff was open to doubt, the Association system was the target of more serious criticism.

The evolution of the Association of African and Malagasy States was traced from Part IV of the Treaty of Rome to the Yaounde Conventions of 1963 and 1969, in Chapter III. The preferences between France and her dependencies, Belgium and the Congo, and so on, are listed in the annexes to the General Agreement and were permitted

(1) See Annex D for full text of Article XXIV, sections 4-8.

since they existed prior to 1947. Objections to the Association began, however, when the EEC decided to extend these preferences to other members of the Common Market. Technically, this move constituted the establishment of new preferences. However, the EEC maintained that the Association was creating a new free trade area including the Six and the Eighteen, and that this was legal under Article XXIV, which reads:

'The provisions of this Agreement shall not prevent the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area.'

Several conditions govern the application of this rule, among which is the proviso that customs union or free-trade areas shall abolish duties and other trade restrictions 'on substantially all the trade in products originating in such territories'.

Article 133(3) of the Treaty of Rome allows associated countries to levy customs duties in certain circumstances, such as when needed for the protection of infant industries, or for revenue purposes. Contracting Parties of the GATT maintained that this provision prevented the Association from being a true free-trade area, since it did not eliminate tariffs on 'substantially all the trade between the parties', and therefore contravened Article XXIV of the GATT.

This objection ignores the fact that the exception contained in Article 133(3) is purely in the interests of the associates which are all developing countries. It does not nullify the intention to create a free-trade area any more than the omission of agricultural goods from the arrangements of the European Free Trade Association prevents this regional group from being generally accepted as a genuine free-trade area.

In 1957-8, a Working Party of the GATT considered the terms of the EEC Association, but no final decision was taken except that the Six concluded that 'if at any time, contrary to their expectations, damage to the interest of third parties could be proved, the EEC would take steps to mitigate it.'⁽¹⁾

By 1965, the GATT had enunciated a new rule regarding the principle of reciprocity, that developed countries were not to expect reciprocity from developing countries with regard to tariff concessions.⁽²⁾ On these grounds, the GATT and UNCTAD members, and especially developing non-associated members, challenged the right of the EEC to ask for reciprocity in association agreements with developing countries, that is, to ask for the notorious 'reverse' preferences. EEC spokesmen, however, maintain that there are no reverse preferences, only free trade areas and customs unions.

A free trade area implies reciprocity in tariff concessions, and therefore, an anomaly appears to exist in the rules of the GATT. Preferential arrangements are allowed only if they lead to the formation of customs unions or free trade areas, but on the other hand, developed countries should not expect reciprocity from developing countries. Yet without reciprocity, customs unions and free trade areas cannot be formed. Thus, the GATT would appear to ignore, or object to, the possibility of customs unions or free trade areas between developed and developing countries.

When the EEC signed the Lagos Convention with Nigeria in 1966, and the Arusha Convention with East Africa in 1968, similar allegations of infringements of the GATT rules were made. With regard to the principle of reciprocity in the Lagos agreement, the

(1) W.G. Barnes, Europe and the developing world, PEP European Series no. 2, London, Chatham House, 1967, p.13.

(2) See Annex D, Article XXXVI, 8.

Nigerian negotiators considered the problem as follows. Nigeria wanted an agreement similar to that of the Yaounde Convention, but less comprehensive. This included reciprocity in trade concessions since it established a free trade area. But Nigeria could not offer complete reciprocity in tariff matters and eventually it was decided that the Nigerian preferences offered to the EEC would be nominal.

Following this decision, allegations were made that the free-trade area was fictitious because the concessions offered by Nigeria related to a small portion of Nigeria's trade. But a Nigerian spokesman concluded that 'where a preference is created, it is a consequence of, not a condition for, creating a free-trade area, nor can the magnitude of the preference created invalidate the existence of a free-trade area'.⁽¹⁾

The same arguments have been applied to the Arusha Convention, although the preferences given by East Africa to the EEC are somewhat more extensive than in the Lagos Convention.

It is difficult to defend the legality of such association agreements as the Lagos and Arusha Convention, under the GATT rules, although the more comprehensive agreement of the Yaounde Convention may pass the test of Article XXIV. On the other hand, the following aspects must be considered before condemning these agreements.

Under a free trade area, there is no common external tariff and therefore associates are free to apply tariffs of their choice to third countries. Thus they could, if they wish, extend the same tariff concessions which they apply to imports from the EEC, to other members of the GATT.

Benefits received by the African countries outweigh those received by the EEC. This is why doubts regarding the legality of these arrangements have not discouraged a number of other nations

(1) P.N.C. Okigbo, Africa and the Common Market, London, Longmans, 1967, p.130.

from seeking agreements with the EEC and some of these countries are currently negotiating for that purpose.

Arrangements such as the Arusha Convention could lead to more comprehensive ones, and therefore could be considered as 'interim agreements leading to the formation of a customs union or free trade area'. (Article XXIV, 5).

With regard to trade agreements with the European Community, the early arrangements were non-preferential. In the agreement with Iran in 1963, for instance, the reduction in the common external tariff of the EEC was extended to other GATT parties, but the products involved were of interest mainly to Iran: hand-knotted woollen carpets, etc. This was also the case with the first agreement between the EEC and the Lebanon in 1964. The more recent agreement with Lebanon is preferential and therefore against the GATT rules. The trade agreement with Spain, however, is a customs union (or leading up to a customs union) and does not extend to other countries the tariff reductions between Spain and the EEC.

The official view of the GATT on this matter is not unanimous. Generally, the more recent association and trade agreements are deplored. '... what is most questionable is the creation of preferential trade links between a few developed and one, or a few, developing countries here and there through new discriminatory agreements for which no historical justification can be claimed.'⁽¹⁾ Detailed examination of certain agreements however, has brought out three tendencies among the GATT members.⁽²⁾ Some of the Contracting Parties are of the opinion that the agreements are not inconsistent with the GATT rules, since the declared objective of the parties,

(1) General Agreement on Tariffs and Trade, Press Release, Address given by Mr. Long, Director-General of the GATT, 26th January 1970, GATT/1051, p.3.

(2) AAMS, Tunisia, Morocco, Spain and Israel - with the EEC.

the provisions of the agreements and their content are consistent with the letter and spirit of Article XXIV. Other countries feel the agreements are not consistent with the GATT rules because there is no plan to show how the associations would achieve a full free trade area or customs union. Finally, some countries make no categorical statement on the compatibility of the agreements with the GATT rules.⁽¹⁾

The reasons for this divergence of views are often found in the circumstances of the countries expressing these views. For example, it was felt that

'if Britain becomes a member of the European Economic Community, there would appear to be no reason, from the point of view of her own interests or those of the developing members of the Commonwealth, why she should not support the continuation of association If, on the other hand, Britain does not become a member of the European Economic Community, association and other special arrangements ... are likely to prove disadvantageous both to her and to the developing countries of the Commonwealth, ... therefore, it would be in Britain's interest as well as that of the Commonwealth to work for world-wide arrangements.'⁽²⁾

As will be shown in Chapter X, sources of conflict in international trade are frequently due to differences in tariff structure, size of internal market and special interests.

(1) General Agreement on Tariffs and Trade. GATT activities in 1970/71, Geneva, 1972, p. 51.

(2) W.G. Barnes, Europe and the Developing World, ... p. 46.

D. THEORETICAL ASPECTS

Customs union theory has considered specifically the problem of full preference (as in a customs union) versus partial preference (as in a preferential agreement).

Jacob Viner points out the illogicality of considering 100% preference as good and 99% preference as bad. On the legal side, if it is the degree of preference which makes it contrary to most-favoured-nation obligations, and if customs unions can be regarded as compatible with these obligations, then preferential agreements, involving a lesser degree of preference, must be even more so.

'The moral is that on both the economic and legal side the problem is too complex to be settled by simple maxims. A 50% preference is economically either less desirable or more desirable than a 100% preference according only as preference at all is under the circumstances desirable or undesirable.'⁽¹⁾

Nevertheless, Viner singles out one area where partial preference may be worse than customs unions: the removal of tariff barriers in a customs union is non-selective, and must lead to both trade-creating and trade-diverting effects. In the case of preferential agreements, however, they are usually selective, and it is possible and even probable that the preferences selected will be of the trade-diverting kind.

More recent theories of customs unions suggest that a partial reduction of duties on imports from partners is more likely

(1) Jacob Viner, The Customs Union Issue, New York, Carnegie Endowment for International Peace, 1950, p. 50.

to increase welfare than a complete removal of restrictions within the area.⁽¹⁾ The reason for this is that the first reduction of duties within the preferential area contribute to more gain from trade expansion than each subsequent reduction. On the other hand, the loss from trade diversion will continue as the degree of preference increases.

This generalization is questioned by Mikesell because

'we are not concerned simply with the readjustment of existing trade patterns, but rather with alternative principles for the direction of investment which will establish the trade and production patterns a decade or so hence.'⁽²⁾

There is, therefore, no consensus of opinion as to whether a full or partial preferential system is more beneficial, in spite of the fact that the GATT accepts the former in Article 24 of the Agreement and disapproves of the latter. This was probably due to the fear that to allow all preferential systems would have opened the door to the bilateralism which plagued international trade in the inter-war period. A minor point - but of significance to small countries - is that the administration of a customs union may be more straight-forward than selective preferences.

The problem of deciding which type of preference is better, stems from the dual aspect of economic integration, a

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- (1) J.E. Meade, The Theory of Customs Unions ... 1955, pp. 56 ff.;
 R.G. Lipsey, The theory of customs unions: a general survey,
The Economic Journal, vol. LXX, No.279, September 1960, pp. 506 ff.;
 H.G. Johnson, Money, Trade and Economic Growth, ... 1962, p. 45.
- (2) P. Robson (ed.) International Economic Integration, (R.F. Mikesell,
The theory of common markets as applied to regional arrangements
 among developing countries) ... p. 176.

movement towards free trade and simultaneous increase in discrimination. This also explains wide differences of attitudes towards the Association. Some GATT parties regard the Association agreements as discriminatory arrangements resulting in the so-called 'reverse preferences'. The official view of EEC is expressed as follows:

'The Commission proposes that in respect of trade matters the Association should be based on the principle of the free trade area. The acceptance by the associated states of the mutual free trade area principle does not entail any obligation for them to grant preferences to the Community. They retain complete tariff autonomy in their relations with third countries, and complete freedom to negotiate on such matters.'⁽¹⁾

The Association has also been regarded as 'a unique form of development co-operation in that it combines trade and aid under the supervision of special institutions'.⁽²⁾

E. RECENT EVOLUTION OF THE GATT'S VIEW ON PREFERENCES

Since the beginnings of the GATT in 1947, the attitude of the Contracting Parties have undergone a certain change with regard to tariff preferences. We have seen that Article I of the General Agreement condemned new preferences but condoned existing ones. At the same time, the principle of reciprocity in trade

(1) Commission of the EEC. Memorandum of the Commission to the Council on the future relations ... Luxemburg, 1973, p. 5.

(2) Ph. P. Everts (ed.) The European Community in the World, (R. Cohen, Europe and developing countries), Rotterdam, University Press, 1972, p. 124.

matters was upheld.

By 1965, when Part IV was added to the GATT, it was agreed that developing countries should not be asked to reciprocate tariff concessions made by developed countries. This was an acceptance that, in certain cases, preferential treatment is justified. This was reaffirmed in 1971 when a waiver was granted for the establishment of Generalized Preferences in order to promote industrialisation in developing areas.⁽¹⁾

Thus the main reason for this change in the position of the GATT on preferences was the wish to assist developing countries. There are two other factors, however, which may lead to further alteration in the GATT regulations, the position of the United States in world trade and the movement towards economic integration.

Although the United States is still the major trader when considered as an individual nation, exports from the EEC as a unit, now exceeds those of the States.⁽²⁾ Japan is also rapidly becoming one of the giants in world trade. The forthcoming multilateral trade talks will be conducted on this new basis, which may affect the GATT regulations since the General Agreement is not an immutable treaty.

'The GATT was founded when the United States was on a pinnacle of pre-eminence. The GATT's rules, of which the most important are reciprocity and non-discrimination, basically enshrined American preconceptions. Now, in trade terms, the balance of power has shifted. It would be surprising if the ground rules, or at least the interpretation of them, did not change.'⁽³⁾

(1) See Chapter VIII.

(2) In 1970, the United States' total exports were 43 226 million dollars, whilst the exports of Six totalled 45 210 million dollars (extra-EEC). The difference will increase with the enlargement of the Community. (Source: EEC, Foreign Trade, Monthly statistics, Brussels).

(3) The Economist, February 28th, 1970, p.65.

In addition, the United States drastically affected its position in the GATT when it imposed a surcharge of 10% on all imports in August 1971. This was a sudden and unprecedented move on the part of the most important founder of the GATT, and although understandable at the time, due to imperative needs of the United States economy, nevertheless it shook the whole concept of the GATT more than any other breach of the General Agreement.

The recent trend towards regional integration may also act upon the GATT's views on preferences. A growing number of countries are forming free trade areas and common markets in various parts of the world, and several nations are entering into trade agreements with the EEC. The latest group of agreements are those between the EFTA countries and the enlarged Community, which established free trade in Western Europe for industrial goods only. It is doubtful whether this constitutes 'substantially all the trade' between the countries involved.⁽¹⁾

To conclude, association and trade agreements between the EEC and several countries are discriminatory and therefore against the philosophy of the GATT, but since these arrangements are increasing in number, and they result in some trade liberalisation, there is a strong possibility that this development will lead to a change in the GATT's views on preferences.

(1) This aspect will be considered in more detail in Chapter IX, pp. 186-8.

CHAPTER VIIIGENERALIZED PREFERENCES

Origin - Brasseur plan - United Nations Conference on Trade and Development - Punta del Este speech - the case for and against generalized preferences - reactions from developed and developing countries - types of schemes - effects on donor country - assessment.

The granting of preferences by some countries to a few others has generally been looked upon with distrust and criticism by those not involved in the arrangements. In spite of this, the extension of the Association system of the EEC has had an impact on the attitude of the GATT towards tariff preferences, as was shown in the previous chapter. This trend has been reinforced by a more recent type of preferences, called the Generalized Scheme of Preferences (GSP).⁽¹⁾

It has been felt for some time that developing countries should be assisted in their efforts to develop their economy. They need to expand their exports in order to purchase imports of consumer and capital goods. So far, most of their exports have been primary products. As returns on these goods are characterized by great instability, some developing countries have been trying to diversify their economies and to export semi-manufactured and manufactured goods. In developed countries, tariffs on primary products are usually nil or low, but tariffs on manufactured goods are higher. Moreover, manufactured goods from developing countries have to compete with goods from other industrialised nations.

(1) Sometimes called the Generalized System of Preferences.

Therefore it has been maintained that assistance should be given - by all developed nations - in the form of preferential tariffs for imports of manufactured and semi-manufactured goods from all developing countries. Although the least developed nations are not likely to benefit a great deal from the GSP since their industrial potential is low, the more advanced among developing countries - for example, Latin American countries - may stand to gain from generalized preferences, especially in the field of semi-processed agricultural products.

Thus the GSP is meant to redress the balance between developed and developing countries. In particular, it is hoped that it will help the problem of infant industry in the third world, since preferential tariffs in the markets of developed countries might provide the necessary encouragement to the industries of developing areas, most of which are still at a very early stage of economic development. Local markets in developing countries are unlikely to absorb the optimum output of those industries for some time, and markets abroad are therefore needed for the development of those areas.

The original plan was for all developed countries to give preferential treatment to exports from all developing countries. That is why it is called 'generalized' preferences, in opposition to the Association or the Commonwealth preferential systems, which apply only between some developed and some developing countries. As will be shown in this chapter, the plan which was finally accepted was for each developed country to apply its own GSP to all developing countries.

The Association system of the EEC has played a part in the establishment of the GSP. Although the first requests for

tariff preferences for manufactured goods from developing countries pre-date the Treaty of Rome of 1957, these requests intensified when the Association took shape, because many developing countries did not share in the benefits given by the Community to the associates. Thus the impact of the Association system has been to accelerate the global acceptance of the GSP.

The purpose of this chapter is to trace the origin and development of generalized preferences and the part played by the Association system, to discuss the advantages and disadvantages of the GSP and the GATT position in this matter, and finally to outline problems of implementation.

A. ORIGIN AND DEVELOPMENT OF GENERALIZED PREFERENCES

1) The early years

The first attempt to include a system of preferences in a legal code of international trade occurred in 1947, during the negotiations of the ill-fated International Trade Organisation (ITO). In the Havana Charter, which was meant to lay down a set of rules for trade between nations, Article XV reads:

'The Members recognise that special circumstances, including the need for economic development or reconstruction, may justify new preferential agreements between two or more countries in the interest of the programmes of economic development or reconstruction of one or more of them.'

There followed certain well-defined conditions and safeguards. Although Article XV of the Charter was seeking the acceptance of new preferential agreements for some countries, Articles XVI and XVII tried to establish a general most-favoured-nation treatment and an elimination of preferences. However, the Havana Charter was not ratified and the ITO was abandoned. We have seen that the

GATT accepted existing preferences but disallowed new preferences.

In the years following the signing of the GATT in 1947, the gap between developed and developing countries became a matter of concern for all, and ways and means of reducing this gap were sought. Thus, as the industrialised parts of the world began to accept the responsibility of helping the third world, the concept of generalized preferences gained ground.

Additional support was given by special preferential arrangements entered into by certain countries, such as the 1948 agreement between the United States and some Pacific islands, between Italy and Lybia in 1951 and between Australia and Papua-New Guinea in 1953.⁽¹⁾ These agreements could have paved the way for a more flexible approach to the problem of preferences for developing countries, but GATT was still wary of an extension of new preferences, and it rejected the 1954 proposal from Britain to allow preferential agreements between any developed country and a dependent territory, as well as the suggestion from Chile, in the same year, to include Article XV of the Havana Charter in the General Agreement. The reason put forward for this refusal was once again the predominance of the principle of non-discrimination. Moreover, it was feared that this move would make certain developing countries permanently dependent on preferential treatment from their Metropolis, and that the interests of those nations not included in such agreements would be impaired.

Following the signing of the Treaty of Rome in 1957, it became evident that a large number of developing countries would benefit from the newly-established EEC Association system. This spurred other developing countries, especially in Latin America, to renew their pressure for a revision of the GATT rules and for

(1) See pp. 142-4.

special treatment of their exports. A report of a GATT Committee in 1959 concluded:

'The Committee noted that some less-developed countries have the investment and the technological resources for the processing of raw materials and are able to produce efficiently some manufactured goods. The Committee recommends that Contracting Parties, particularly industrialized countries, should urgently consider lowering barriers to the development of the export of such goods and should in their economic policies take into account the urgent need of less-developed countries to increase their export earnings and should so far as possible avoid hindrance to the import of such goods from such countries.'⁽¹⁾

In 1962, this was followed by a Programme of Action proposed by less-developed countries at the Twentieth Session of the GATT. Inter alia, the following suggestions were made:

- (a) 'Duty-free entry into the industrialized countries shall be granted to tropical products by 31st December 1963;
- (b) industrialized countries shall agree to the elimination of customs tariffs on the primary products important in the trade of less-developed countries;
- (c) industrialized countries should also prepare urgently a schedule for the reduction and elimination of tariff barriers to exports or semi-processed and processed products from less-developed countries providing for a reduction of at least 50 per cent of the present duties over the next three years.'⁽²⁾

A GATT Working Party was set up to study the problem of preferences, and the United Nations Secretariat was also asked to make a study of the matter for the Conference on Trade and Development, due to take place in 1964. During this preparation, conflicting interests emerged both among developed and developing countries. This aspect will be examined below.

(1) General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents, Eighth Supplement, Geneva, 1960, p.140.

(2) General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents, Eleventh Supplement, Geneva, 1963,
pp. 205-206

2) The Brasseur Plan. A step towards the GSP was taken in May 1963, when M. Brasseur, the Belgian Minister of Foreign Trade and Technical Assistance, proposed a plan for generalized preferences, at the GATT Ministerial Meeting of May 1963. It was a system of selective, temporary and degressive preferences, which in fact form the basis of the GSP recently implemented by the EEC. It was hoped that most developed countries would take part, but it was not essential for all countries to do so. In the Brasseur plan, as it became known, the developed countries would not expect reciprocity for preferences granted. Efficiency of production and sales methods in developing countries would be stimulated by the fact that preferences would be temporary and degressive, and would be discontinued when the infant industries entered the competitive stage. The preferences would also be selective for three reasons: (a) no government, accountable to the public, could undertake to give automatic preferences to all developing countries, for all manufactured goods; (b) special care could be taken, with selective preferences, of the needs of the least developed countries; and (c) the selective approach constituted a safeguard against competition of goods produced under so-called abnormal conditions, such as cheap labour, etc. The GSP would be the result of negotiations initiated by developing countries.

The Brasseur plan was acceptable to the EEC, since it allowed the maintenance of existing preferences to associates, but it was not formally approved by the Six at that time, because of divergence of opinion; for example, although France supported the selective approach, Germany preferred a general system of preferences. Several other countries, among both developed and developing countries, disliked the idea of selective preferences.

3) United Nations Conference on Trade and Development (UNCTAD), 1964.

The first Conference for Trade and Development, held under the auspices of the United Nations in New York, was a disappointment for the protagonists of GSP. Generalized preferences were discussed at length and the principle of GSP was accepted by 69 in favour, with 8 against and 23 abstentions. Unfortunately, the United States voted against it, and no developed country would proceed without American support. The other votes against generalized preferences were cast by Switzerland, Sweden, Canada, Finland, Iceland, Norway and Poland, some because they upheld the principle of non-discrimination, others for reasons unrelated to the scheme. The abstentions were mainly due to the vagueness of the proposals, whereas the Soviet countries abstained because of references to countries with 'centrally planned economies'. (1)

Nevertheless, in the Final Act of the Conference, the great majority of countries agreed with the principle of 'assisting the industrial development of developing countries by the extension of preferences in their favour' and asked the United Nations Secretary-General to arrange for a committee of Government representatives to consider the matter 'with a view to working out the best method of implementing such preferences on the basis of non-reciprocity from the developing countries'.

Although the 1964 United Nations Conference on Trade and Development did not achieve a great deal from the point of view of the GSP, it helped the developing world in other ways.

It was the first time that developing countries spoke with a collective voice, and soon after the conference, UNCTAD was established as a permanent organ of the United Nations, under

(1) In February 1965 the Soviet Union informed the United Nations that it had abolished customs duties on all goods imported from the less-developed countries. (The New York Times, February 5th, 1965, p.39).

the General Assembly resolution 1995 (XIX) on December 30th, 1964. The resolution defined the principal functions and membership of the Conference and its permanent organ, the Trade and Development Board. On the recommendation of the Board, the General Assembly decided on December 20th, 1965, to establish the headquarters of the secretariat in Geneva and a liaison office at the United Nations in New York. At its first session, the Board laid down the terms of reference of four Committees: on Commodities, Manufactures, Invisibles and Financing related to trade, and Shipping. These Committees meet each year and have created a number of subsidiary bodies to deal with particular problems coming under their terms of reference. 'The main impact of UNCTAD comes from its recommendations which emanate mainly from developing countries and which, in general, crystallize issues they wish to have resolved so as to promote their economic and social advancement'.⁽¹⁾

4) The General Agreement on Tariffs and Trade. During the early sixties the GATT members were considering the special problems of developing countries, and the ways in which their trade could expand. It was realized that not only should the developing nations receive better prices for their primary products, but every effort should be made to encourage the production and export of semi-manufactured and manufactured goods. Thus, two changes were sought in the rules of the GATT, (a) reciprocity in tariff concessions should not be expected from developing countries, and (b) tariff preferences should be granted to exports from developing countries, and not extended to all members of the GATT on a most-favoured-nation basis.

(1) Edgar Jones, The Fund and UNCTAD, Finance and Development, vol. 8, no.3, September 1971, p.29.

In November 1964, the Contracting Parties to the GATT in their Second Special Session approved - for submission to their governments - the text of a new Part IV to the General Agreement, containing special provisions to help the trade and development of the less-developed countries. The Final Act was signed on 8th February 1965 and indicated an important change in the GATT towards the acceptance of special treatment of less-developed countries.⁽¹⁾

However, tariff concessions given by developed countries were still to follow the most-favoured-nation principle, and it is this rule which became the target of attacks from developing countries. They felt that a tariff concession offered to all members of the GATT would work to the disadvantage of the less-developed countries, who would be unable to compete against more advanced producers. Thus demands became more insistent for a GSP.

The existence of two large areas of preferences, the Commonwealth and the EEC Association system, influenced the development of a GSP in two ways: on the one hand, it spurred those developing countries who did not benefit from such a system, such as the Latin American countries, to press for a system of preferences from which they would benefit; on the other hand, those countries which benefitted from the existing preferential schemes were far more hesitant about a GSP which would reduce the advantages which they received from their membership of the Commonwealth or their associate status.

5) Punta del Este. After the United Nations Conference on Trade and Development of 1964, Latin America began to press the United States for preferential treatment of their industrial goods.

(1) Article XXXVI, 8: The developed Contracting Parties do not expect reciprocity for commitments made by them in trade negotiations, to reduce or remove tariffs and other barriers to the trade of less-developed Contracting Parties.

The United States had voted against the GSP at the Conference, but their position was weakened in 1965 by the preferential agreement with Canada for automotive products.⁽¹⁾ The first sign of a change in the American attitude was the President's speech in Punta del Este, Uruguay, in 1967, where he said that his Administration was prepared to explore the possibility of a GSP. This renewed interest in the scheme, and the Special Group on Trade with Developing Countries of the Organization for Economic Cooperation and Development (OECD)- led by France, the United Kingdom, Germany and the United States - presented a report to the second session of UNCTAD in New Delhi in 1968. This proposal took the form of a summary of points which member countries of the OECD agreed should be featured in any GSP, but details were not given. Moreover, UNCTAD set up a Special Committee on Preferences.

6) Second UNCTAD, 1968. The problem of a GSP was discussed at the New Delhi conference, but no agreement was reached because it was found impossible to set up a single generalized preference scheme, and it was left to the developed countries to submit their own individual schemes. Moreover, most developed countries made it a condition of implementation of their scheme that all developed countries would do the same. One important drawback was that the United States threatened to abandon their scheme if discriminatory and reverse preferences were not removed from other schemes.⁽²⁾

7) The GATT waiver. The introduction of generalized preferences was finally accepted and sanctioned by the GATT in 1971, in the form of a ten-year waiver, under the terms of Article XXV of the General Agreement. This allows developed countries to lower tariffs

(1) See p.144.

(2) See David Wall, EEC General Preferences, European Community, January, 1972, p.22.

on imports from developing countries, without having to extend this to all members of the GATT on a most-favoured-nation basis. The waiver was requested by a number of industrialised nations, and adopted by the GATT member governments in a postal ballot.⁽¹⁾

B. THE CASE FOR AND AGAINST GENERALIZED PREFERENCES

During the twenty year period leading to the approval of a GSP, many arguments for and against the scheme were put forward.⁽²⁾ Self-interest led some countries to stress some aspects and neglect others. We shall consider the arguments in favour and those against the GSP before examining briefly the problem of the GATT rules in this matter.

1) Arguments in favour of the GSP

(a) The most important argument for the GSP is that developing countries need help to further their economic development. In the last few years, this point has gained emphasis from the fact that the latest rounds of the GATT negotiations have not achieved a great deal for the specific problems of developing countries. Since their economy is far less advanced than the economy of industrialised nations, they need extra concessions.

Underlying this argument is the assumption that the GSP will automatically help export industries in developing countries and therefore, assist in their economic development. This is similar to the well-known argument for infant industry. Newly-established industries need protection in the early stages, because costs per unit are high until the level of output reduces prices to competitive levels. In the same way, industries in developing countries need help, not only because most of them are in the infant

(1) The GATT Press Release 1082, 26th June 1971.

(2) See inter alia, John Pincus, Trade, aid and development, New York, McGraw-Hill, 1967, pp. 197 ff.

stage but also because of existing conditions in developing countries generally. In those areas, the level of education and training is very low and the infra-structure of the economy is poor or non-existent. Roads, railways and other services have to be established and the new industries usually have to share in these costs. An additional burden is the lack of experience of both entrepreneurs and workers. If it is accepted that infant industries need help in developed areas, they certainly need greater assistance in developing countries. The question remains, however, as to whether tariff preferences are an effective way of helping.

The point has been made that two conditions must exist if tariff preferences are to help developing countries to export semi-manufactured and manufactured goods.⁽¹⁾ First, the prices charged by the developing country must be below those of the domestic producers in the developed country giving preferences (the 'donor' country), and secondly, the price must also be less than the price of competing goods produced in other developed countries plus the tariff applicable in each case.⁽²⁾ In other words, the price of developing countries' exports may exceed those of exports from other areas, but by an amount smaller than the tariff applicable to those goods, assuming no tariff on exports from developing countries. Where the preference given is merely a lower tariff, this raises the price of developing countries' exports by the same amount.

An absence of tariffs for exports from developing countries will place these goods on an equal footing with domestic firms in

(1) Gardner Patterson, Would tariff preferences help economic development?, Lloyds Bank Review, April 1965, no.76, p.25.

(2) Whether 'nominal' or 'effective' tariff. For discussion on this point, see H.G. Johnson, Trade preferences and developing countries, Lloyds Bank Review, April 1966, no.80, pp. 13 ff. Also John Pincus, Trade, aid and development, pp. 189-190.

the developed country thus giving them a better chance to increase their export earnings. Again, where the preference given by the developed country is not a zero tariff, but simply a lower tariff, the prices of those exports will have to be below prices of domestic goods by the amount of the tariff.⁽¹⁾

(b) Other arguments put forward in favour of generalized preferences can be mentioned briefly. It has been felt for some time that foreign aid given to developing areas is not sufficient for their development and should be supplemented by easier access to the markets of developed countries. Besides, tariff preferences are more acceptable than direct aid, both from the political and psychological viewpoint. The administrative costs of such schemes to 'donor' countries would be negligible and by allowing each developed country to propose their own scheme, danger of damage to their economy would be reduced to a minimum.

2) Arguments against the GSP

We have seen that it took a long time for countries to accept the principle of generalized preferences. The reasons for this reluctance are numerous. Some developed nations, particularly the United States, wanted to maintain the principle of non-discrimination in tariff matters. Developing countries which benefitted from special treatment were also unwilling to encourage the adoption of a GSP which would inevitably reduce their margin of preference. Regarding the GSP from a global viewpoint, the following arguments were put forward.

(a) The most serious drawback of generalized preferences is that this will reduce the chances of further liberalisation of trade,

(1) The term 'domestic goods' include goods from countries which may be linked in a free trade area or a customs union with that particular country and therefore economic integration between developed countries tends to reduce the benefits of preferences.

since any further tariff reduction will tend to reduce the margin of preference granted to developing countries. It is true that the GSP may be used as an excuse to maintain tariffs at their present level but this argument carries less weight if the principle of degressive preferences is accepted. Degressive preferences mean that the margin of preference will be gradually decreased. In other words, the preferential tariffs will be gradually increased until they reach the level of the normal tariff. The rate of increase will depend on each GSP proposal.

(b) The GSP may perpetuate the economic dependence of poor countries on rich countries. This argument may be used against any form of aid to developing areas and it is a weak one. It must be accepted that developing countries will remain dependent on developed areas for a long time and the establishment of the GSP will not alter that situation. Moreover, it should be left to the developing countries themselves to decide on this matter, and those which dislike dependence on rich countries may elect to remain out of the scheme.

(c) It is also maintained that the GSP may perpetuate inefficiency in the industries of developing countries. This point is often stressed in discussions on infant industry protection. It is exact that new industries tend to rely on protective tariffs once they have been granted, but it is generally accepted that it is reasonable to extend these protective tariffs to genuine cases of infant industry, in order to assist them during the early stages of growth. In the same way, the GSP is meant to help new manufacturing or processing industries in developing areas during their initial stages of growth.

(d) Another argument against the GSP is the danger of discrimination against developing as well as developed countries.

When it became evident that a single scheme could not be accepted by all countries, the fear was expressed that certain individual schemes could be arranged in such a way as to benefit some developing countries to the detriment of others, for instance, by giving better treatment to a product originating principally from a specific developing country. This is a valid argument and cannot be ignored. From the point of view of developed countries, the GSP may lead to an inequitable distribution of the burden of preferences, some developed countries 'paying' more than others. It is obviously difficult if not impossible to devise a GSP which lays an equal burden on all 'donor' countries, but as each developed country will plan and implement its own scheme, this problem is alleviated to a certain extent. It may be added that any group scheme, such as United Nations action programmes or EEC common policies, falls more heavily on some countries than others and may be regarded as discriminatory by some writers, but this is no reason to reject international economic co-operation.

3) Generalized preferences and the GATT

A consideration of the GSP in the framework of international trade should examine whether the acceptance of generalized preferences indicates a movement towards trade liberalisation or another departure from the GATT principle of non-discrimination.

It was shown above that the GSP was unacceptable for many years by members of the GATT, because it discriminates against developed countries. It is only under pressure from developing countries that it was legalised by the GATT through the granting of a waiver. From the point of view of the third world, the GSP is a means of liberalising their trade with developed areas. If

preferences succeed in increasing this trade, the conclusion can be drawn that although a discriminatory measure, the GSP is at the same time a step towards trade liberalisation.

It is difficult to assess, however, whether the GSP will result in trade-creation rather than trade-diversion. If the developed countries' demand for those manufactured goods which can be produced by developing countries - and are subject to the GSP - is elastic, then it is possible that exports from developing countries may expand and benefit those areas. If on the other hand, demand is inelastic, the GSP may cause trade-diversion at the expense of the producers in other developed countries. It may therefore benefit less efficient producers at the expense of more efficient producers, and for this reason, attract criticism. On the other hand, it can be regarded as a form of aid since it involves a transfer of income from one group (in developed areas) to another (in developing areas).

As the GSP are to be established by lowering tariffs for some goods and not be raising them against others, these schemes may be regarded as being in the spirit of the GATT, in the same way as free trade areas and customs unions, which - according to Article XXIV of the GATT - must have as their aim an increase in trade among the parties concerned and not the erection of barriers to the trade of other nations. Discrimination in international trade and trade liberalisation are not necessarily mutually exclusive.

C. IMPLEMENTATION OF GENERALIZED PREFERENCES

Once the principle of generalized preferences for manufactured and semi-manufactured goods from developing countries was

accepted by most trading nations, a host of problems became apparent as details of the schemes had to be worked out.

The number of donors and of recipients was the first concern. Obviously the ideal situation would be for all developed countries to grant preferences to all developing countries, but there could be no question of coercion. Thus developed countries were left free to offer preferences. As regards the number of recipients, the principle accepted was that of 'self-election'. It is impossible to divide all trading nations into developed and developing countries as many of them are on the border-line of development. It is assumed however, that most of the 'Group of 77' will ask for preferential treatment.⁽¹⁾ By the device of safeguard clauses, developed countries retain the right to refuse preferences to any developing country for particular reasons, in spite of the discriminatory aspect of such exceptions.

Other problems to be solved were the types of goods which should receive preferences, the depth of tariff concessions to be made, the duration of the schemes and other provisions such as those concerning 'sensitive' products.

It soon became evident that no agreement would be reached on a single scheme of preferences and that the best way to proceed was to leave each donor country to propose and implement its own scheme.

An important divergence of opinion among both developed and developing countries relate to the special case of 'reverse preferences', that is preferences given by developing countries to developed countries as for example, in the Commonwealth preferential system and the EEC Association system. Although some developed countries, such as the United States and Sweden, would

(1) Group of active developing countries, formed by Raúl Prebisch, within the framework of UNCTAD, and with a present membership of 96.

like these reverse preferences to be abolished, the countries involved in the scheme are reluctant to do so. In fact, some of these developing countries have regarded the GSP as a threat to their own trade, since it would automatically reduce the margin of preference given to their goods in certain markets, such as the EEC or the Commonwealth. These developing countries finally accepted GSP because they hoped that what would be lost in 'traditional' markets would be gained by preferential entry into new markets.

It was hoped at some stage that the least advanced among developing nations could receive special treatment in a GSP, although the earlier plans were to have a completely non-discriminatory system. The first point obviously contradicts the second. Nevertheless, the hope was expressed that 'special preferences could be granted to the less advanced developing countries' and at the same time, 'the ultimate objective should be to adapt existing preferential arrangements to the new system of preferences in such a way that there is no discrimination among developing countries, and so that developing countries presently obtaining such preferences should continue receiving benefits under the new system at least equivalent to those they now enjoy'.⁽¹⁾ The term 'equivalent' is ambiguous, as those countries enjoying preferences prior to the establishment of GSP may stand to lose if all developing countries are granted preferences in the same markets. It must be accepted that either the GSP is non-discriminatory, that is, applied equally to all developing countries, or exceptions are made (a) for the least developed areas, and (b) for those who were receiving special treatment before the establishment of the GSP.

(1) John A. Pincus, (ed.), Reshaping the world economy: Rich countries and poor, (Towards a new trade policy for development, Raúl Prebisch), New Jersey, Prentice-Hall, 1968, p.122.

This particular aspect lost its importance when it became obvious that no single system would be acceptable to all developed countries. Each donor country was left free to submit its own scheme and several decided on selective preferences, that is, not all manufactured and semi-manufactured goods, but a selection of these, would receive preferential treatment.

The special benefits received by some developing countries were not cancelled but were automatically reduced by preferences given to others. This aspect caused some misgivings and the Eighteen African countries associated with the Common Market said that the offer of the EEC to establish a GSP 'causes us some anxiety because it is too liberal and might dilute our own advantages'.⁽¹⁾

Developing countries which had not previously received preferential treatment welcomed the general acceptance of GSP but some of them felt that the number of goods covered and the depth of the tariff cuts were insufficient. These points were raised at an UNCTAD meeting in 1970, and a speaker for the EEC replied that the proposals were the result of 'enormous effort and that it was the maximum possible at this stage'.⁽²⁾

From the point of view of the donor countries, the drawbacks of the GSP include administrative costs and increased competition for domestic goods as well as competition in other developed countries' markets. Certain aspects of the scheme, as for example the selection of the goods to benefit from preferences, may cause a certain amount of political friction among both donors and recipients. The fear has been expressed that the United States, in particular, might be tempted to embark on a protectionist policy, if Congress agrees to grant generalized preferences.⁽³⁾

(1) UNCTAD Press Release, TAD/INF/459(PREF), 23rd September 1970.

(2) UNCTAD Press Release, *ibid.*

(3) See Gardner Patterson, 'Would tariff preferences help economic development?', Lloyds Bank Review, April 1965, no.76, p.30. This view has been rejected by H.J. Johnson in 'Trade preferences and developing countries', Lloyds Bank Review, April 1966,

Attitudes of developed countries vary: the EEC and the United Kingdom regard the GSP as an extension of their present system of preferences to some developing countries, whilst the United States consider preferences as a deviation from their normal policy of non-discrimination and thus have only recently and somewhat reluctantly accepted the principle of the GSP.

Since the GATT waiver of 1971, several developed countries grant generalized preferences to manufactured goods from developing countries.

'Preferential schemes under the GSP have been implemented by the European Economic Community, Japan, Norway, Denmark, Finland, Ireland, New Zealand, Sweden, the United Kingdom, Switzerland and Austria. Two countries, the United States and Canada, have not yet put into effect their schemes of generalized preferences. Australia has been granting tariff preferences to developing countries since 1966.'

Of the socialist countries of Eastern Europe, Bulgaria, Czechoslovakia and Hungary have introduced preferential schemes of generalized preferences. The USSR has provided duty-free entry for imports of goods from developing countries since 1965.⁽¹⁾

The schemes vary.⁽²⁾ Most of them have been established for a period of ten years and all of them (except Japan's) incorporate an escape clause 'which allows the preferences to be modified in the event of a claim of injury to domestic producers or proven disruption of markets'.⁽³⁾ In addition, the EEC scheme offers preferences only up to a certain ceiling, and the EEC, Britain and the United States exclude most textiles from their schemes.

(1) UNCTAD Monthly Bulletin No.80, April 1973.

(2) See Annex E for the EEC and the United States proposals.

(3) David Wall, EEC general preferences: How effective will they be? European Community, January 1972, p.22.

The United Kingdom scheme was more advantageous than the EEC's, since it offered preferences without ceilings. However, the enlargement of the Community will require the harmonization of the GSP of the EEC, Britain, Ireland and Denmark.

Although all developing countries may, in principle, apply to become recipients of generalized preferences, there are exceptions, such as in the case of the United States which automatically excludes 'countries which do not receive the benefit of the most-favoured-nation clause or those which grant preferential advantages to other developed countries, unless they have undertaken to cease doing so by 1976'.⁽¹⁾ This last clause is aimed at the EEC associates or countries having concluded preferential agreements with the Community.

D. EFFECTS OF GENERALIZED PREFERENCES ON DONOR COUNTRY

The impact of generalized preferences on the production and consumption of the developed donor country is illustrated in Figure 14. These effects depend on several assumptions, the most important of which is the interchangeability of the goods from developed and developing exporting countries. Other assumptions include the absence of transport costs and constant-cost curves for imports.

(1) Jean Royer, The United States trade reform bill: background note, International Chamber of Commerce, Document 102/106, Paris, 1973. (Economic and financial policy, Commission on the expansion of international trade), p.10.

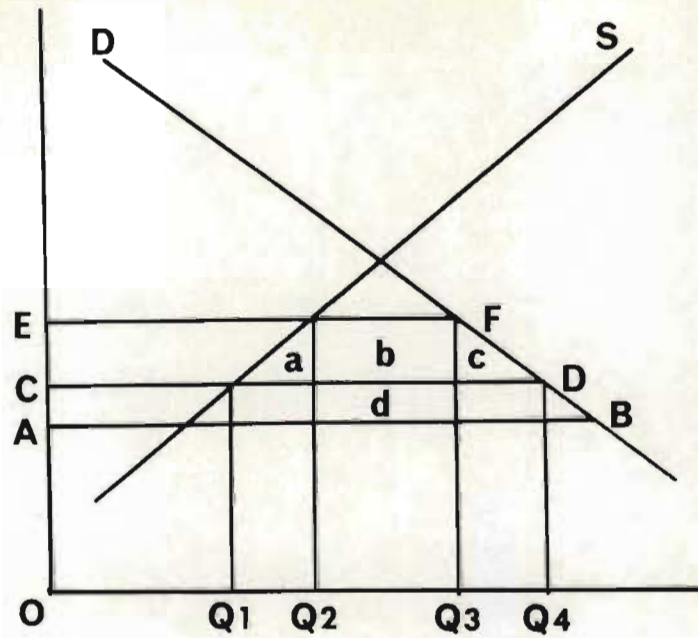


Figure 14: Effects of GSP on Donor Country

D and S are the demand and supply curves of the domestic developed country. AB and CD are the supply curves for goods from another developed country, and from the developing country ('recipient' country) respectively. Before GSP, the domestic country imposes tariff AE on all imports. She will consume OQ_3 , of which OQ_2 is produced locally and Q_2Q_3 is imported from the developed country (assumed to be lower-cost than the developing country).

The domestic country now applies the GSP to imports from the developing country, that is, tariffs on those imports are eliminated, but they are still applied to imports from the developed areas. The domestic country will now consume OQ_4 . Domestic production has been reduced to OQ_1 but imports have increased to Q_1Q_4 and they all come from the developing country.

From a comparison between Figure 14 and Johnson's illustration of trade-creation and trade-diversion (see pages 46-47, Figures 10 and 11), it is evident that the effects of the GSP are similar to those of a customs union, where AB could be the supply curve of an outside country and CD the supply curve of the union partner.

In Figure 14, areas a and c illustrate trade-creation (production and consumption effect). Tariff revenue (b + d) falls away: b may be considered as a transfer so that it is neither a gain nor a loss to the domestic country, but area d represents trade-diversion (from low-cost developed producer to high-cost developing producer) and must be weighed against trade-creation, to find out the net loss or gain.

The system of generalized preferences and economic integration both contain elements of free trade and discrimination, but they differ in two important aspects:-

- 1) Tariffs concessions are not reciprocal.
- 2) Concessions are partial since they apply only to manufactured and semi-manufactured products from developing countries.

E. ASSESSMENT

From the above discussion the following conclusions may be drawn. After about twenty years, the GSP was finally accepted by the trading nations of the world for two main reasons. Its purpose is the economic development of the third world and it is regarded as non-discriminatory because it is meant to apply to all developing countries. This second point explains why the GSP has not attracted the same criticism as the EEC Association system, in spite of the fact that in practice, the GSP involves some discrimination among developing countries.

Every effort should be made to bridge the gap between the rich and poor countries, but it is doubtful whether generalized preferences will result in industrialisation in developing areas. We have seen that free entry into the European Community has not had a great effect upon the trade results of associated countries and it will probably be the same for the GSP. Moreover, industrial tariffs being generally low, preferential rates applied to exports from developing countries will have a minimal effect on their economy. Problems of development are considerable and cannot be solved by a few tariff concessions.

On the other hand, as generalized preferences are urgently requested by developing countries, implementation of this scheme by a large number of developed nations may have a salutary psychological effect on the relationship between the poor and rich countries, and should therefore be carried out. It can be added that the chances of effectiveness of the GSP might be increased if the terms of the schemes were more generous - for instance, applying zero tariffs to textile exports from developing areas - but developed countries are not prepared to go this far. It must also be remembered that the GSP is barely two years old and that a longer period of time is needed to assess more accurately its possible effects on developing countries.⁽¹⁾

From the global point of view, the GSP discriminates against developed countries and is an important departure from the principle of non-discrimination. However, the GSP is not the only deviation from the GATT rule of equality of treatment in trade matters. The following chapter will consider several other factors which have, in our opinion, contributed to the failure of the principle of non-discrimination.

(1) See T. Murray, How helpful is the generalized system of preferences to developing countries?, The Economic Journal, vol. 83, no. 330, June 1973, pp. 449-455

CHAPTER IXTHE FAILURE OF THE RULE OF NON-DISCRIMINATION
OF THE GATT

Exceptions to Article I - Article XXIV - Article XIV - Article XXXV - new chapter on developing countries - generalized preferences - preferential agreements - EFTA - basic reasons for the failure of the principle of non-discrimination.

When the General Agreement on Tariffs and Trade was signed in 1947, the Contracting Parties agreed to two main principles. The first was that member countries should grant each other the same favourable treatment in trade matters as they grant any other member country. This is commonly called the most-favoured-nation clause and has long been a feature of commercial treaties; in the context of the GATT it is usually described as the principle of non-discrimination. The second principle is that protection should be given only by means of tariffs and that these should be progressively reduced in order to liberalise international trade.

A consideration of the achievements of the GATT over the last twenty-five years leads to the conclusion that the principle of non-discrimination has been a failure, whereas the principle of tariff reduction has been successfully applied. The purpose of this chapter is to draw attention to the causes of the failure of the first principle of the GATT, and the part played by the Association system of the EEC.

Several factors have weakened the principle of non-discrimination but the fundamental cause of this failure lies in the unrealistic expectation of equality of treatment on a world-wide scale, as was envisaged by the founders of the GATT. Trade interests have forced certain countries to enter into discriminatory arrangements with others, and this was made possible by the early acceptance of exceptions to the rule, which vitiated the principle of non-discrimination from the beginning.

A. CONTRIBUTORY FACTORS

The factors which contributed to the failure of the most-favoured-nation principle are as follows:-

- 1) Article I excludes a number of established preferences of long standing from the most-favoured-nation principle.
- 2) Article XXIV allows customs unions, free trade areas and interim arrangements, opening the way to 'legal' discrimination.
- 3) Article XIV permits the discriminatory application of quantitative import restrictions to protect the balance of payments in special circumstances.
- 4) Article XXXV permits the non-application of the GATT rules between certain Contracting Parties.
- 5) Part IV of the GATT introduced in 1965, exempts developing countries from several of the GATT rules.
- 6) The recently-established Generalized Scheme of Preferences allows discrimination in favour of developing countries in the application of tariffs for manufactured and semi-manufactured goods.
- 7) Finally, the GATT is unable to prevent an increasing number of preferential arrangements which do not quite conform to the rules laid down in the General Agreement.

We shall consider each of these points.

1) Article I

The first article of the GATT illustrates the compromise between those Contracting Parties which upheld non-discrimination as the main rule, and those who were not prepared to give up their existing system of preferences. This point has been discussed above.⁽¹⁾ Thus, the GATT insisted that the most-favoured-nation treatment should be applied between members, but allowed existing preferences to remain, such as those applied in the British Commonwealth, the French Union and others. It was obviously a weakness to draw a distinction between existing preferences and new preferences, and consequently several new preferences have been accepted by the GATT members, either by the grant of a waiver or tacitly. Although it was first hoped that existing preferences would be progressively abolished, the practical outcome was that the margin of preference would not be increased. Thus, Article I introduced a weakness into the main GATT rule from the beginning.

2) Article XXIV

This article specifically allows free trade areas, customs unions and interim agreements leading to the formation of either kind of economic integration, provided that certain conditions are met: first, the tariffs of the customs union must not be higher than those of the member countries prior to union, and secondly the arrangements must involve 'substantially all the trade' between the parties. This article has been invoked several times since the signing of the GATT, due to the growth of regional integration. From the point of view of international trade, customs unions and free trade areas illustrate the duality of non-discrimination within the customs union, and discrimination towards non-members.

(1) See pp. 140-1.

This makes it difficult to decide whether regional integration is a step towards trade liberalisation or a step away from it. If this trend is regarded as the creation of larger customs territories, then the abolition of tariff barriers between the countries forming the customs union indicates a liberalisation of trade, even if this is not extended to all Contracting Parties of the GATT, in other words, even if it is discriminatory. Furthermore, the loose wording of Article XXIV has led to a wide interpretation of the expression 'interim agreements' and 'substantially all the trade', as shown in the EEC Association and trade agreements and in the Stockholm Convention of 1960, establishing the European Free Trade Association. Thus certain agreements are regarded by some as conforming to Article XXIV of the GATT, and by others as preferential agreements (see pp. 145-150).

3) Article XIV

Exceptions to the rule of non-discrimination, as regards quantitative restrictions are contained in Article XIV. Although these restrictions are generally forbidden by the GATT, they are allowed in cases of balance-of-payments difficulties, as long as they are applied non-discriminately (Article XIII). However, Article XIV contains provisions which authorise the discriminatory application of quantitative restrictions in special cases. Several Contracting Parties have evoked this article in support of their import control policies, among them the Republic of South Africa.

4) Article XXXV

The General Agreement includes other 'escape clauses' such as Article XXXV, which gives any Contracting Party the possibility of not applying the GATT rules to another Party. This was the last article of the original Agreement. The non-application may occur (a) if the two parties have not entered into tariff

negotiations with each other, and (b) if either party, at the time one of them becomes a member of the GATT, does not consent to such application.

This article has been invoked by South Africa against Japan, and by India against South Africa, the first for economic reasons, and the second for political reasons. It has also been invoked in other cases, but the most striking example was that concerning the accession of Japan to the GATT. When this country finally became a Contracting Party in 1955 - its membership had been deferred for many years for a variety of reasons - fourteen countries representing about 40 per cent of the foreign trade of the GATT's members, invoked Article XXXV against Japan. This article has been called 'the great loophole' because it opened the door to widespread discriminatory practices for protective purposes.⁽¹⁾

The factors mentioned so far were all part of the General Agreement when it was signed in 1947. They indicate the unwillingness of the Contracting Parties to commit themselves unconditionally to the principle of non-discrimination. This led to the inclusion of these exceptions which covered most likely problems, but on the other hand, these exceptions vitiate the main principle to a considerable extent and may be construed as an example of bad faith on the part of the original signatories. The principle of equality of treatment was upheld as the main principle of the GATT, but provision was made for ways to avoid it when trade interests are in danger. However, several countries might have refused to participate in the GATT if these escape clauses had been absent.

(1) See Gardner Patterson, Discrimination in international trade, the policy issues, Princeton, Princeton University Press, 1966, p.19.

5) Part IV of the GATT

In 1965, a new chapter was added to the General Agreement to deal with the special problems of developing countries, although Article XVIII dealt with the conditions under which countries may deviate from the rules of the GATT in order to encourage their economic development. The new section, Articles XXXVI to XXXVIII, deals with such exceptions in greater detail, and lays down the commitments of developed countries in this respect. The most explicit departure from the principle of non-discrimination is Section 8 of Article XXXVI which reads: 'Developed Contracting Parties do not expect reciprocity for commitments made by them in trade negotiations, to reduce or remove tariffs and other barriers to the trade of less developed Contracting Parties'. The new chapter aims at assisting the trade of developing countries, but it also stresses disparities between developed and developing areas.

6) Generalized preferences

The establishment of a Generalized Scheme of Preferences for manufactured goods from developing countries is legalised under the GATT, by the granting of a waiver from the rule of non-discrimination to the developed countries who request it. This is a major deviation from the first principle of the GATT, as was shown in Chapter VII, especially since the GSP is not equally applied to all developing countries and individual schemes lead to a variety of treatment of goods and countries.

Points 5) and 6) concern developing countries. These deviations from the main principle of the GATT are explained by the fact that although the original Agreement was signed by only 23 countries in 1947, many nations acquired independence during the

following years, and by 1965, a large number of the new Contracting Parties were developing nations and differed in many ways from the original signatories to the General Agreement. It soon became evident that the rules framed for developed countries were inadequate for the needs of developing countries, and therefore, further exceptions were made to the principle of non-discrimination.

7) Preferential agreements

We have seen that several preferential agreements were condoned by the GATT through the granting of waivers.⁽¹⁾ In addition, even though some of the agreements of the EEC Association system do not quite conform to the rules of the GATT, divided opinions have increased the possibility of a de facto acceptance of these agreements, especially where they concern developing countries. Finally, the recent formation of the European free trade zone of 16 nations illustrate yet another contravention of the GATT's Article I. As these EEC-EFTA arrangements concern developed countries and have aroused criticism from the United States, it is worthwhile considering these agreements in some detail.

The European Free Trade Association was formed in 1960 by seven countries when Great Britain, Portugal, Austria, Switzerland and the three Scandinavian countries signed the Stockholm Convention. The later accession of Finland and Iceland brought the total to nine. In 1972, the entry of two EFTA members, Britain and Denmark, into the European Community necessitated new arrangements between the remaining seven members of EFTA and the enlarged EEC, in order to prevent new trade barriers from arising between Britain and Denmark, on the one hand, and EFTA countries on the other.

(1) See pp. 142-4.

The Stockholm Convention did not include trade in agricultural goods and therefore, it may be said that the free trade area of EFTA did not include 'substantially all the trade', as laid down by Article XXIV of the GATT. However, EFTA did not receive a waiver to legalize this exception. Instead, a Working Party of the GATT examined the terms of the Convention and reported on it, concluding that 'there remain some legal and practical issues which would not be fruitfully discussed further at this stage. Accordingly, the Contracting Parties do not find it appropriate to make recommendations to the parties ...'⁽¹⁾ Thus, although the GATT found that the Stockholm Convention did not quite conform to the provisions of Article XXIV, it was considered not important enough to make recommendations and demand modifications.

The agreements between the EEC and EFTA countries also exclude agricultural products, and it is reasonable to assume that the same attitude will prevail in the GATT. As the EFTA members have no common external tariff, seven separate agreements were negotiated with the EEC.

It is interesting to note that some EFTA members such as Switzerland and Sweden, which were outspoken supporters of the principle of non-discrimination and critical of preferential arrangements, urged the EEC to come to terms with EFTA and to abolish tariffs between them. It appears that most nations do not disapprove of discrimination as a matter of principle, but object when discrimination threatens their own interests.

'The Scandinavians, who had led the critics of the Coal and Steel Community, apparently raised but few objections to the EEC proposals. From the outset, they thought they would sooner or later get inside the preferential walls, first as part of the original European-wide

(1) General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents, Ninth Supplement, Geneva, 1961. p.20.

area scheme, and, later, in the melding of the European Free Trade Association with the Common Market.'⁽¹⁾

It should be mentioned here, that a wide free trade zone in Europe is not a new idea. In 1955, Britain, who did not want to commit herself to the closer integration planned by the Six, suggested the formation of a free trade area among the countries belonging to the OEEC.⁽²⁾ This was rejected by the Six, but when the Common Market showed signs of success, the idea of linking the EEC with EFTA was promoted once again and has now become a reality.

B. EVALUATION

The above discussion brings us to the conclusion that the principle of non-discrimination of the GATT has been a failure, since it is evident that discrimination in international trade cannot be eliminated. The numerous exceptions to Article I have weakened the main principle of the General Agreement and in addition, subsequent developments such as the GSP and the Association system have all contributed to the ineffectiveness of the main principle of the GATT.

The underlying cause of this failure lies in the difference between the Contracting Parties of the GATT. Not only are there wide differences in their level of economic development, but also in the pattern and evolution of their external trade. Differences in economic development account for recent changes in the GATT rules, such as the GSP, whilst differences in trade patterns have led to regional arrangements of various forms, such as free trade areas and customs unions, with their inherent discrimination

(1) Gardner Patterson, Discrimination in International Trade...., p. 156, footnote 60.

(2) Organisation for European Economic Co-operation, which became the Organisation for Economic Co-operation and Development in

against non-members. It is understandable that this trend is viewed with alarm by those who regard equality in international trade as essential.

Disparities between countries and between trade patterns lead to differences in outlook and objectives. Some look for economic development, others for self-efficiency, others still for a global efficiency in international trade. Thus their aims differ, and their policies follow. Consequently, countries consider discrimination differently. Some see it as a real and dangerous barrier to international trade, whilst others consider discriminatory measures as necessary to promote their own external trade.

These differences of opinion explain the continuing tensions in multilateral trade negotiations such as the forthcoming GATT talks. In the next chapter, we shall examine in more detail these sources on conflict in international trade.

CHAPTER XSOURCES OF CONFLICT IN INTERNATIONAL TRADE

Trade talks - divergence of objectives - stage of economic development - size of internal market - patterns of trade - efficiency - tariff structure - social and political considerations - the 'common' interest.

At the end of 1973, a new round of multilateral trade negotiations will be carried out under the auspices of the GATT. The talks are expected to last two years and will consider a variety of problems, including non-tariff as well as tariff barriers, trade in industrial and agricultural products, and the special needs of developing countries. A special invitation has been extended to developing countries, including non-members of the GATT.⁽¹⁾

It is probable that some GATT rules will be altered as a result of these negotiations. Pressure will be brought to bear on developed countries to improve their GSP schemes or to help developing countries in other ways. Reverse preferences and various regional arrangements will be under attack as well as the principle of non-discrimination. Efforts will be made to contain the increase in protectionism which began soon after the Kennedy Round of the GATT ended in 1967.

It will not be a simple task for so many nations to agree on solutions to such varied problems. The Kennedy round lasted three years and the Six members of the Community took five years

(1) See General Agreement on Tariffs and Trade, Press Release, The 1973 multilateral trade negotiations: the crucial choices ahead. Address by Mr. Olivier Long, Director-General, GATT, to Polytechnic Association, Oslo, 3rd May 1973. GATT/1122.

to agree on the details of the common agricultural policy of the EEC. The difficulty lies not so much in the fact that time is needed to examine a large number of problems but rather in the probability that different viewpoints are bound to lead to conflict.

'Constantly changing circumstances would not present such a challenge to the GATT if all the Contracting Parties shared a common view of their precise objectives. Then common policies and programs might be thrashed out. But the fact is that Contracting Parties have differing views of the function of international trade.'⁽¹⁾

Some countries feel that trade between nations should be carried out with a view to greater economic efficiency; others stress economic development and industrialization; yet others aim at self-sufficiency and seek to protect infant industries.

The aim of this chapter is to examine the causes underlying these differences which lead to conflict in international trade and are likely to handicap the search for the common interest of all trading nations.

The problem is complicated by clashes of sectoral interests within a particular nation; moreover, where negotiations take place with groups such as the EEC, a new dimension is added. Thus besides clashes between sectors of the economy and between sectors and the nation as a whole, there may be conflicts of interests between the members of the group and finally between the group and other negotiating nations. In this maze of diverse interests, negotiators have to look for the common interest without losing sight of their own nation. It is therefore, understandable that sometimes they confuse the two in order to facilitate the task!

In multilateral negotiations, efforts are made towards an ideal framework of international trade, but the elements of this

(1) Kenneth W. Dam, The GATT law and international economic organisation, Chicago, University of Chicago Press, 1970, p. 6.

framework vary according to characteristics of negotiating countries. More specifically, the attitudes of nations are influenced by the stage of development of their economy, the size of their internal market, existing patterns of trade, the efficiency of their export industries, and social and political considerations, whilst procedures of negotiations are complicated by differences in tariff structures and other customs regulations.

An examination of each of these aspects will bring out the causes underlying conflicts in international trade.

1. Stage of development

Wide differences of opinion exist between developed and developing countries as to the aims of international trade. Developed nations tend to stress efficiency in international trade with elimination of trade barriers. Developing countries on the other hand seek mainly an improvement in their economies and especially industrialization. Concessions are requested in order to encourage exports of semi-manufactured goods as well as primary products and preferential treatment in the markets of developed countries are sought. The third world is not impressed by the argument that international trade should be non-discriminatory. If the GSP offers some hope of improving terms of trade of developing countries, they favour it even if it discriminates against developed countries. Where possible, some developing countries go further and enter into special arrangements, such as association or trade agreements with the EEC. If necessary they are prepared to give reverse preferences to form free trade areas or other forms of economic integration in the hope of encouraging development.

Moreover, the issues are complicated by the fact that attitudes of developing countries towards the GSP and reverse

preferences vary according to whether they have already formed close associations with developed countries or not. The former accept the principle of reverse preferences⁽¹⁾ whilst others agree that they are an 'archaic and pernicious hangover from another age.'⁽²⁾ We have seen (Chapter VIII) that some developing countries welcome the GSP but others fear that this new scheme will reduce the preferences which they have hitherto enjoyed in the markets of some developed countries.

Although certain developed countries stress the aim of trade liberalisation and non-discrimination, many of them endeavour to see the viewpoint of the third world. In view of the general acceptance of the needs of developing nations, exceptions have been made regarding certain GATT rules and a number of industrialized nations have offered generalized preferences to developing countries.

2. Size of internal market

This aspect influences attitudes on economic integration. A country with a small internal market looks upon integration as a means of expanding the market and encouraging large-scale production and specialization. Thus a nation may decide to form a free trade area or an economic union and to ignore arguments against this form of discrimination. On the other hand, a country with a large internal market and wide scope for large-scale production has no need for such integration and stresses the discriminatory aspects of regional integration as well as the need for equality of treatment for all trading nations. Members of the EEC, associates and others favour free trade areas and

(1) See Okigbo, Africa and the Common Market, London, Longmans, 1967, p.130.

(2) W. Michael Blumenthal, A world of preferences, Foreign Affairs, vol. 48, no.3, April 1970, p.554.

and similar arrangements whilst the United States with their large internal market generally favour non-discrimination on a world-wide scale. This does not mean that all countries with small internal markets wish to integrate with others. Japan, for example, has been able to expand her markets abroad and to compensate for the shortcomings of her local market. Britain on the other hand, found that world-wide trade links were no longer adequate and sought integration with the Six in order to increase the scope of her industries.

3. Patterns of trade

Past and present trade patterns affect the position of trading nations on certain aspects of international trade. Countries which have for many years exported to certain markets, tend to consider that they have a prior claim to those outlets, whilst others seek to increase exports and look forward to getting a foothold in new markets. Thus some nations prefer the status quo and others look for change. A striking example is the case of the United States and Canada which have been described as the 'traditional' or 'established' exporters of farm products, especially to the EEC and view apprehensively the increase in agricultural production caused by the common agricultural policy.⁽¹⁾ On the other hand, New Zealand has had to seek other markets for dairy products in view of Britain's entry into the Common Market and has recently increased exports to Asian countries, while Japan has increased sales to the United States to such a degree that she has been asked to organize 'voluntary' export control for certain products.

In another context, efforts are made to alter the

(1) Hugh Corbet (ed.), Trade Strategy and the Asian-Pacific region, London, G. Allen & Unwin, 1970, p.21.

traditional pattern of trade whereby developed countries export manufactured goods to developing countries and import primary products from them. This trend is still apparent in the trade of some developed countries and their ex-dependencies, notably in Africa. Countries which benefit from these links are prepared to maintain them, but others - both among developed and developing countries - attack these patterns of trade as relics of the colonial era or as neo-colonialism, and favour their elimination.

4. Efficiency

The degree of efficiency of a country's industries affects multilateral trade talks. A country with several low-cost producers tends to support measures which stress efficiency in international trade and to condemn methods likely to distort free competition. World-wide removal of barriers to multilateral trade will therefore be favoured. On the other hand, countries with high-cost industries try to improve their position and protect their local industries with both tariff and non-tariff barriers, disregarding arguments that the more efficient producers should provide the goods. The dividing line does not necessarily separate developed and developing countries. Among developed nations too, some are more concerned about efficiency in international trade, whilst others may be willing to protect a new industry or some other sector of the economy. For example, agricultural production in parts of the European Community is less efficient than in the United States yet both maintain agricultural protectionism. There may be a variety of reasons for this: national prestige, desire for self-sufficiency, pressure groups or other considerations.

5. Social and political factors

These may also alter the bargaining position of negotiating countries. They give rise to 'sensitive' areas of trade policy. Most developed countries sympathize with demands by developing countries for outlets for their growing industries but at the same time, industrialized nations are obliged to consider depressed or under-developed areas within their borders. Understandably, these areas have a prior claim. This is the reason for the exclusion of textiles from the GSP offer by the United States. Although it is generally accepted that the problem of under-development would be helped by encouragement of labour-intensive industries such as textiles, the United States wishes to protect the textile sector of the economy from low-cost competitors, because the low-income group of her population depends on this form of employment.

Agriculture is another 'sensitive' area in trade policy, and perhaps the most important one. The Kennedy Round of the GATT did not achieve a great deal in this sector.

'It would be difficult to conclude that the GATT's record in the sphere of temperate agricultural commodities is other than one of failure. Not only is effective protection in all likelihood higher on average than in any other sector of the international economy, but there are many indications that the rate of effective protection is increasing.'⁽¹⁾

Most countries in the Western world protect agriculture and this is also the case for Japan. There is no plan to liberalise Japanese agriculture in spite of difficulties due to labour shortages and other aspects. As in the EEC, a large proportion of the farmers are elderly and the typical farm is small. Yet measures such as exposure to foreign competition, which would cause dis-

(1) Kenneth W. Dam, The GATT law, p.257.

satisfaction among the peasants, are avoided for political reasons. During a discussion between the Japanese and American governments on trade liberalisation in 1968,

'whereas Japan offered no resistance in principle to the proposals for the liberalisation of several classes of industrial products, including electronic goods, they refused the American request to remove restrictions on the import of various agricultural products, including beef.'⁽¹⁾

In the EEC, the Common Agricultural Policy has been framed for the purpose of improving the standard of living of the farming community, by protecting them from low-priced imports, improving the structure and efficiency of farms and other measures. In the same way as it is felt that the third world needs help, so the Community is prepared to support and assist farmers which constitute a depressed sector in the Common Market. Thus social and political considerations add complexity to differences of opinion in international negotiations.

6. Tariff structures

Conflict becomes apparent in trade negotiations with regard to the methods used in reducing tariffs, because nations have different tariff structures. This was evident at the beginning of the Kennedy Round. The United States with a large number of high tariffs were in favour of linear cuts, i.e. reduce all tariffs by 50% or some other acceptable percentage, whereas the EEC preferred the objective of tariff harmonization, the reduction of high tariffs to lower levels. The Common Market, with a relatively low common external tariff for industrial goods, suggested the procedure of 'écrêtement'⁽²⁾ to reduce high tariffs, but this was rejected in favour of reciprocal linear cuts.

(1) Hugh Corbet (ed.), Trade strategy and the Asian-Pacific region, (G.C. Allen, Japan's place in trade strategy),..... p.97n.

(2) Literally, 'taking the peaks off'.

Non-tariff barriers are also controversial and countries will no doubt attack those barriers used by others but try to preserve those which form part of their customs regulations and formalities. The GATT has compiled a catalogue of some 800 non-tariff barriers classified in 27 categories.⁽¹⁾ 'Subsequently, it was agreed that the Committee should focus on a few specific non-tariff barriers that appeared least controversial and thus most likely to be amenable to multilateral negotiations.'⁽²⁾

Sources of conflict in international trade have been examined separately but they often overlap and this aspect complicates issues further. Moreover, nations will not necessarily find themselves on the same side for the duration of negotiations for they may agree on some points and disagree on others.

This review of differences in attitudes, opinions and objectives among trading nations may lead to a pessimistic view of the forthcoming trade talks. Is there a 'common' interest or simply a number of national and sectoral interests which are bound to clash? One may find some reassurance in the evolution of the EEC: after the failure of the European Defence Community in 1954, it may have seemed that a united Europe was doomed. Yet the Messina conference of 1955 led to the Rome Treaty two years later. Once the objective of an economic union was agreed upon, solutions were found to conflicts of national interests. Difficulties will be far greater however, in multilateral talks including a large number of nations of such diversity. The only hope lies in an increase of the international - as opposed to national - outlook which might be assisted by some form of supranational thinking in international trade.

(1) For example, escape clauses, anti-dumping practices, customs valuations, government procurement policies, state trading, mixing regulations. See H.G. Johnson (ed.), New Trade Strategy for the World Economy, London, G. Allen & Unwin, 1969, p.36n.

(2) International Monetary Fund, IMF survey, August 27th, 1973, p.244.

CHAPTER XICONCLUSIONS

The Association system of the European Economic Community has inaugurated a new trend in international trade. The network of association and trade agreements has reduced trade barriers and given financial and technical assistance to many developing countries. It is a manifestation of the growing tendency towards economic integration and therefore, both liberates trade between some countries and discriminates against others.

The main impact of the Association has been on Africa, since twenty-five African states have entered into agreements with the Community and there is a strong possibility that others will join, following Britain's entry into the Common Market. The entry of Commonwealth countries into the Association is eroding the old division between francophone and anglophone Africa and is changing the attitude of many developing countries towards these arrangements.

The analysis of trade figures between the associates and the EEC showed little change in their pattern over a period of eleven years, but it would be imprudent to conclude that the Association has had no effect on the associates as a whole.

The theory of customs unions demonstrates the effects of integration on the levels of production and consumption of member countries and the impact of this change on trade with outside countries. It fails to generalise on whether the overall effect is favourable or not, because it concentrates on only a few of the many variables in the economies concerned. The value of the more

recent literature on integration is that it enlarges the field of investigation and demonstrates that the socio-political aspects of customs unions and economic unions are inextricably linked with the economic factors. This is why empirical studies of the effects of integration are inevitably limited to a particular sector of the communities concerned, and cannot claim to illustrate the over-all effect of economic integration.

Even if detailed statistics on growth and investment in associated countries were available, it cannot be proved that changes in these fields are the result of economic integration with the EEC. The present state of theory does not allow us to isolate changes which are due to integration and those which are the result of other causes. The field is wide open to speculation.

There is no evidence that the Association has damaged the trade of non-associates, and on the positive side, it has led to a diversification of the trade of associates amongst members of the EEC, and the enlargement of the Community from Six to Nine will no doubt amplify this development.

South Africa's trade with Britain will be affected by Britain's entry into the EEC but it is difficult to give an accurate estimate of this change. By the time the common external tariff is fully implemented in 1977, progress in marketing practices and export promotion on the part of South African exporters may offset the loss of preference in the British market. Although it is doubtful whether South Africa can ever become an associate of the EEC, due to her level of economic development and political factors, a trade agreement with the Community is a possibility.

The South African Customs Union may have to be re-examined if the Commonwealth members of the Union, Botswana, Swaziland and Lesotho, become associates of the EEC.

Differences of opinion persist as to the nature of association and trade agreements. The Community presents them as free trade areas and non-preferential agreements, and therefore within the rules of the GATT, but some Contracting Parties maintain that the agreements are preferential in character and against the spirit of the GATT. This controversy is subsiding for reasons which are set out below.

The principle of non-discrimination of the GATT received a severe blow when most trading nations agreed to the principle of Generalized Preferences. This provides easier entry for manufactured goods from developing countries into the markets of developed areas, and thereby assist in the economic development of the third world. The Association system of the EEC contributed to the GSP by spurring non-associates to demand preferences similar to those given by the EEC to their associates.

In spite of Article I of the GATT stressing the need for equality in trade matters, there is evidence of substantial discrimination in international trade, partly due to the impossibility of a strict application of the principle and partly due to the growing trend towards economic integration. A revision of the GATT rules on this point is indicated and it is possible that this will be discussed during the forthcoming multilateral trade talks. The success of these talks will depend on the recognition of the various positions which may be taken regarding the purpose of international

trade and on the amount of tolerance shown towards different viewpoints.

Problems of developing countries will feature prominently in the discussions. The EEC is currently formulating a development policy. The Treaty of Rome does not mention the Community's position vis-à-vis developing countries because in 1957 it was primarily concerned with the establishment of an economic union in Europe, and only provided for the relationship between the Six and their dependencies. In 1972 however, the Summit Conference of the EEC called upon the member states to implement a comprehensive policy of world-wide development co-operation, without losing sight of the vital importance of the maintenance and development of the Association.⁽¹⁾ Thus the Association will influence future dealings between the enlarged EEC and developing countries as a whole.

Although acceptance of regional arrangements is increasing, they remain a controversial matter. It is generally accepted that developing countries need some form of discrimination in their favour - although some writers would prefer a rigid adherence to the principle of non-discrimination - but many advocate universal arrangements such as the Generalized Scheme of Preferences rather than regional ones. On the other hand, regional agreements have their supporters.

'Contrary to what many seem to believe, the goal of a development policy should not be complete liberalisation of trade. Only a limited number of countries would profit

(1) - See Commission of the European Communities. Memorandum of the Commission to the Council on the future relations between the Community, the present AASM states and the countries in Africa COM(73) 500/fin. Luxembourg, 1973.

from such measures. That is why I am in favour of associations and preferential trade agreements, as long as the picture of an underdeveloped world of identical nations is wrong.'⁽¹⁾

The controversy which has surrounded the Association system since its inception is showing signs of abatement. Several reasons account for this. First, the Association has been extended to an increasing number of developing countries, always at the request of these nations. Secondly, the free trade arrangements between the enlarged Community and the remaining members of the European Free Trade Association have led to a more tolerant interpretation of Article XXIV of the GATT. Thirdly, forty-four out of the eighty-three members of the GATT are now either members of the EEC, associates, or countries which have signed a trade agreement with the Community, and this has reduced the effectiveness of criticism of the Association as a whole. Finally, the attention of the trading nations of the world is focussed less on tariff matters and more on problems such as currency and mobility of factors of production.

'Commodity trade has ceased to be the all-important element in foreign economic relations. Capital movements, movements of workers, exchange of know-how, travel, and other services play a fast-growing role and will continue to do so; and, correspondingly, the importance of tariffs and non-tariff barriers to commodity trade is decreasing in the overall picture.'⁽²⁾

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- (1) Ph. P. Everts (ed.), The European Community in the world, (R. Cohen, Europe and the developing countries, summary of the discussions), Rotterdam, University Press, 1972, p.194.
- (2) Pierre Uri (ed.), Trade and investment, policies for the Seventies, new challenges for the Atlantic area and Japan, (Günther Harkort, Response to G. Curzon's paper), New York, Praeger, 1971, p.69. This view is at variance with the general opinion regarding the importance of non-tariff barriers.

In the framework of international trade policy, the Association system of the EEC has had an impact which extends far beyond the countries involved. Developing countries in particular are tempted to join the Association or enter into trade agreements with the Community, to obtain benefits similar to those which the associates already enjoy. Alternatively, these countries may press for trade assistance from other developed areas. The third world as a whole will be affected since the EEC development policy will take into account the Association system. The probability of a change in the rules of the GATT or of a de facto acceptance of the Association by the GATT members will increase, due to the growing number of agreements between the EEC and countries which are Contracting Parties to the GATT. Finally, the Association system has contributed to the trend towards economic integration which is liberalising trade between a large number of nations.

ANNEX ARELEVANT ARTICLES OF THE TREATY OF ROME, 1957.Part Four.The Association of Overseas Countries and Territories

ARTICLE 131

The Member States hereby agree to bring into association with the Community the non-European countries and territories which have special relations with Belgium, France, Italy and the Netherlands. These countries and territories, hereinafter referred to as "the countries and territories", are listed in Annex IV to this Treaty.

The purpose of this association shall be to promote the economic and social development of the countries and territories and to establish close economic relations between them and the Community as a whole.

In conformity with the principles stated in the Preamble to this Treaty, this association shall in the first place permit the furthering of the interests and prosperity of the inhabitants of these countries and territories in such a manner as to lead them to the economic, social and cultural development which they expect.

ARTICLE 132

Such association shall have the following objects:

1. Member States shall, in their commercial exchanges with the countries and territories, apply the same rules which they apply among themselves pursuant to this Treaty.
2. Each country or territory shall apply to its commercial exchanges with Member States and with the other countries and territories the same rules which it applies in respect of the European State with which it has special relations.
3. Member States shall contribute to the investments required by the progressive development of these countries and territories.

4. As regards investments financed by the Community, participation in tenders and supplies shall be open, on equal terms, to all natural and legal persons being nationals of Member States or of the countries and territories.

5. In relations between Member States and the countries and territories, the right of establishment of nationals and companies shall be regulated in accordance with the provisions, and by application of the procedures, referred to in the Chapter relating to the right of establishment and on a non-discriminatory basis, subject to the special provisions made pursuant to Article 136.

ARTICLE 133

1. Imports originating in the countries or territories shall, on their entry into Member States, benefit by the total abolition of customs duties which shall take place progressively between Member States in conformity with the provisions of this Treaty.

2. Customs duties imposed on imports from Member States and from countries or territories shall, on the entry of such imports into any of the other countries or territories, be progressively abolished in conformity with the provisions of Articles 12, 13, 14, 15 and 17.

3. The countries and territories may, however, levy customs duties which correspond to the needs of their development and to the requirements of their industrialisation or which, being of a fiscal nature, have the object of contributing to their budgets.

The duties referred to in the preceding sub-paragraph shall be progressively reduced to the level of those imposed on imports of products coming from the Member State with which each country or territory has special relations. The percentages and the timing of the reductions provided for under this Treaty shall apply to the difference between the duty imposed, on entry into the importing country or territory, on a product coming from the Member State which has special relations with the country or territory concerned and the duty imposed on the same product coming from the Community.

4. Paragraph 2 shall not apply to countries and territories which, by reason of the special international obligations by which they are bound, already apply a non-discriminatory customs tariff at the date of the entry into force of this Treaty.

5. The establishment or amendment of customs duties imposed on goods imported into the countries and territories shall not, either de jure or de facto, give rise to any direct or indirect discrimination between imports coming from the various Member States.

ARTICLE 134

If the level of the duties applicable to goods coming from a third country on entry into a country or territory is likely, having regard to the application of the provisions of Article 133, paragraph 1, to cause diversions of commercial traffic to the detriment of any Member State, the latter may request the Commission to propose to the other Member States the measures necessary to remedy the situation.

ARTICLE 135

Subject to the provisions relating to public health, public safety and public order, the freedom of movement in Member States of workers from the countries and territories, and in the countries and territories of workers from Member States shall be governed by subsequent conventions which shall require unanimous agreement of Member States.

ARTICLE 136

For a first period of five years as from the date of the entry into force of this Treaty, an Implementing Convention annexed to this Treaty shall determine the particulars and procedure concerning the association of the countries and territories with the Community.

Before the expiry of the Convention provided for in the preceding sub-paragraph, the Council, acting by means of a unanimous vote, shall, proceeding from the results achieved and on the basis of the principles set out in this Treaty, determine the provisions to be made for a further period.

Part SixGeneral and Final Provisions

ARTICLE 238

The Community may conclude with a third country, a union of States or an international organisation agreements creating an association embodying reciprocal rights and obligations, joint actions and special procedures.

Such agreements shall be concluded by the Council acting by means of a unanimous vote and after consulting the Assembly.

Where such agreements involve amendments to this Treaty, such amendments shall be subject to prior adoption in accordance with the procedure laid down in Article 236.

Source: Treaty establishing the European Economic Community and connected documents, Secretariat of the Interim Committee for the Common Market and Euratom, Brussels. 1957.

ANNEX BLIST OF ASSOCIATES UNDER PART IV OF THE TREATY OF ROME

French West Africa including: Senegal, the Sudan, Guinea, the Ivory Coast, Dahomey, Mauretania, the Niger and the Upper Volta;

French Equatorial Africa including: the Middle Congo, Ubangi-Shari, Chad and Gaboon;

St. Pierre and Miquelon, the Comoro Archipelago, Madagascar and dependencies, the French Somali Coast, New Caledonia and dependencies, the French Settlements in Oceania, the Southern and Antarctic Territories;

The Autonomous Republic of Togoland;

The French Trusteeship Territory in the Cameroons;

The Belgian Congo and Ruanda-Urundi;

The Italian Trusteeship Territory in Somaliland; and

Netherlands New Guinea.

Source: As for Annex A.

ANNEX CRELEVANT ARTICLES OF THE CONVENTION OF ASSOCIATION
(YAOUNDE CONVENTION) 1963Trade.

ARTICLE 1

With a view to promoting an increase of trade between the Associated States and the Member States, strengthening their economic relations and the economic independence of the Associated States and thereby contributing to the development of international trade, the High Contracting Parties have agreed upon the following provisions which shall regulate their mutual trade relations.

ARTICLE 2

1. Goods originating in Associated States, shall, when imported into Member States, benefit from the progressive abolition of customs duties and charges having an effect equivalent to such duties, resulting between Member States under the provisions of Articles 12, 13, 14, 15 and 17 of the Treaty and the decisions which have been or may be adopted to accelerate the rate of achieving the aims of the Treaty.

2. Nevertheless, upon the entry into force of the Convention, Member States shall abolish the customs duties and charges having an effect equivalent to such duties which they apply to the goods originating in Associated States which are listed in the Annex to this Convention.

At the same time Member States shall apply the common customs tariff duties of the Community to imports of these goods from third countries.

3. Imports from third countries of unroasted coffee into the Benelux countries on the one hand, and of bananas into the Federal Republic of Germany on the other hand, shall be subject to the terms set out respectively, as to unroasted coffee, in the Protocol this day concluded between the Member States and, as to bananas, in the Protocol concluded on 25 March 1957 between the Member States and in the Declaration annexed to this Convention.

4. Application of the provisions of this Article shall not predetermine the treatment to be applied to certain agricultural products under the provisions of Article 11 of this Convention.

5. At the request of an Associated State, there shall be consultations within the Association Council regarding the conditions of application of this Article.

ARTICLE 3

1. Each Associated State shall accord identical tariff treatment to goods originating in any of the Member States; Associated States not applying this rule on the entry into force of this Convention shall do so within the following six months.

2. In each Associated State goods originating in Member States shall benefit, under the terms set out in Protocol No.1 annexed to this Convention, from the progressive abolition of customs duties and charges having an effect equivalent to such duties which that Associated State applies to imports of these goods into its territory.

Provided always that, each Associated State may retain or introduce customs duties and charges having an effect equivalent to such duties which correspond to its development needs or its industrialization requirements or which are intended to contribute to its budget.

The customs duties and charges having an effect equivalent to such duties levied by Associated States in accordance with the foregoing sub-paragraph, as also any alteration which they may make in these duties and charges under the provisions of Protocol No.1, may not either de jure or de facto give rise to any direct or indirect discrimination between Member States.

3. At the request of the Community and in accordance with the procedures laid down in Protocol No.1, there shall be consultations within the Association Council regarding the conditions of application of this Article.

ARTICLE 4

1. Insofar as an Associated State levies export duties on exports of its products to Member States, these duties may not give rise, de jure or de facto, to any direct or indirect discrimination between Member States and may not be granted than those applied to products exported to the most favoured third country.

2. Without prejudice to the application of Article 13, paragraph 2 of this Convention, the Association Council shall take suitable measures if the application of such duties leads to serious disturbances in the conditions of competition.

ARTICLE 5

1. With regard to the abolition of quantitative restrictions, Member States shall apply to imports of goods originating in the Associated States the relevant provisions of the Treaty, and of the decisions which have been or may be adopted to accelerate the rate of achieving the aims of the Treaty, which they apply in their relations with each other.

2. At the request of an Associated State, there shall be consultations within the Association Council regarding the conditions of application of this Article.

ARTICLE 6

1. Associated States shall, not later than four years after the entry into force of the Convention, abolish all quantitative restrictions on imports of goods originating in Member States and all measures having equivalent effect. This abolition shall be carried out progressively under the conditions set out in Protocol No.2 annexed to this Convention.

2. Associated States shall refrain from introducing any new quantitative restrictions or measures having equivalent effect on imports of goods originating in Member States.

3. Should the measures provided for in Article 3 prove insufficient to meet their development needs and their industrialization requirements, or in the event of difficulties in their balance of payments, or, where agricultural products are concerned, in connection with the requirements arising from existing regional market organizations, Associated States may, notwithstanding the provisions of the two foregoing paragraphs and subject to the terms of Protocol No.2, retain or introduce quantitative restrictions on imports of goods originating in Member States.

4. Associated States in which imports come within the province of a State trading monopoly or of any body which, de jure or de facto, either directly or indirectly limits, controls, directs or influences them, shall take any steps necessary to attain the objectives defined in this Title and to abolish progressively any discrimination in conditions of supply and marketing of goods.

Without prejudice to the application of Article 7 below, foreign trade plans drawn up by the Associated States shall not contain or bring about, de jure or de facto, any direct or indirect discrimination between Member States.

The Associated States concerned shall inform the Association Council of the steps taken to implement the provisions of this paragraph.

5. At the request of the Community, there shall be consultations within the Association Council regarding the conditions of application of this Article.

ARTICLE 7

Without prejudice to the special provisions for border trade, the treatment that the Associated States apply by virtue of this Title to goods originating in Member States shall in no case be less favourable than that applied to goods originating in the most favoured third country.

ARTICLE 8

This Convention shall not preclude the maintenance or establishment of customs unions or free-trade areas among Associated States.

ARTICLE 9

This Convention shall not preclude the maintenance or establishment of customs unions or free-trade areas between one or more Associated States and one or more third countries insofar as they neither are nor prove to be incompatible with the principles and provisions of the said Convention.

ARTICLE 10

The provisions of the foregoing Articles 3, 4 and 6 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy, public security, the protection of human, animal or plant life or health, the protection of national treasures possessing artistic, historic or archaeological value, or the protection of industrial and commercial property. Provided always that such prohibitions or restrictions shall not be used as a means of arbitrary discrimination nor as a disguised restriction on trade.

ARTICLE 11

When drawing up its common agricultural policy, the Community shall take the interests of the Associated States into consideration as regards products similar to and competitive with European products. The Community and the Associated States concerned shall consult together for this purpose.

The treatment applicable to imports into the Community of these products, if they have originated in the Associated States, shall be determined by the Community in the course of defining its common agricultural policy, after consultation within the Association Council.

ARTICLE 12

1. On matters of commercial policy, the Contracting Parties agree to keep each other informed and, should one of them so request, to consult together for the purpose of giving good effect to this Convention.

2. Such consultation shall bear on measures concerning trade with third countries if these measures are likely to harm the interests of one or more Contracting Parties, with particular reference to:

- (a) the suspension, alteration or abolition of customs duties,
- (b) the granting of tariff quotas at reduced or zero duties, other than the quotas referred to in Article 2, paragraph 3, above,
- (c) the introduction, reduction or abolition of quantitative restrictions, without prejudice to the obligations incumbent upon certain Contracting Parties by reason of their membership of G.A.T.T.

3. Upon the entry into force of this Convention, the Association Council shall define the procedure for consultation and exchange of information in respect of the implementation of this Article.

ARTICLE 13

1. If serious disturbances occur in one sector of the economy of an Associated State or jeopardize its external financial ability, that State may take the necessary protective measures, notwithstanding the provisions of Article 3, paragraph 2, sub-paragraph 1 and Article 6, paragraphs 1, 2 and 4.

These measures and the methods of applying them shall be notified immediately to the Association Council.

2. If serious disturbances occur in one sector of the economy of the Community or of one or more Member States, or jeopardize their external financial stability, and if difficulties arise which may result in a region suffering grave economic hardship, the Community may take, or may authorize the Member State or States concerned to take such measures as may prove necessary in their relations with the Associated States, notwithstanding the provisions of Articles 2 and 5.

These measures and the methods of applying them shall be notified immediately to the Association Council.

3. For the purpose of implementing paragraphs 1 and 2 of this Article, priority shall be given to such measures as will least disturb the functioning of the Association. These measures shall not exceed the limits strictly necessary to remedy the difficulties that have arisen.

4. There shall be consultations within the Association Council regarding the measures taken under paragraphs 1 and 2 of this Article.

Such consultations shall be held at the request of the Community in respect of measures under paragraph 1 and at the request of one or more Associated States in respect of those under paragraph 2.

Institutions.

ARTICLE 39

The Institutions of the Association shall be:

- the Association Council assisted by the Association Committee,
- the Parliamentary Conference of the Association,
- the Court of Arbitration of the Association.

ARTICLE 40

The Association Council shall be composed, on the one hand, of the members of the Council of the European Economic Community and members of the Commission of the European Economic Community and, on the other hand, of one member of the Government of each Associated State.

Any member of the Association Council prevented from attending may be represented. The representative shall exercise all the rights of the accredited member.

Proceedings of the Association Council shall only be valid if half the members of the Council of the Community, one member of the Commission and half the accredited members representing the Governments of the Associated States are present.

ARTICLE 41

The office of the President of the Association Council shall be exercised alternately by a member of the Council of the European Economic Community and a member of the Government of an Associated State.

ARTICLE 42

Meetings of the Association Council shall be called once a year by the President.

Furthermore it shall meet whenever necessary, in accordance with the conditions laid down in its rules of procedure.

ARTICLE 43

The Association Council shall express itself by mutual agreement between the Community on the one hand and the Associated States on the other.

The Community on the one hand and the Associated States on the other shall each by means of an internal Protocol determine their procedure for arriving at their respective positions.

ARTICLE 51

1. Disputes concerning the interpretation or the application of the present Convention which might arise between one Member State, several Member States or the Community on the one hand and one or more Associated States on the other, shall be submitted by one of the parties to the dispute to the Association Council which shall seek an amicable settlement at its next meeting. If this cannot be achieved and if the parties to the dispute fail to agree upon an appropriate solution, the dispute shall, at the request of the earliest petitioner, be submitted to the Court of Arbitration of the Association.

2. The Court of Arbitration shall be composed of five members: a President who shall be appointed by the Association Council and four judges chosen from among persons whose independence and competence can be fully guaranteed. The judges shall be

appointed by the Association Council within three months after the entry into force of the Convention and for the duration thereof. Two of the judges shall be appointed by the Council of the European Economic Community and the other two by the Associated States. For each judge, following the same procedure, the Association Council shall appoint a deputy who shall set in the event of the accredited judge being unable to do so.

3. The Court of Arbitration shall act by majority vote.

4. The decisions of the Court of Arbitration shall be binding on the parties to the dispute who shall be under the obligation to take all necessary measures to carry them out.

5. Within three months after the judges are appointed, the Association Council shall lay down the Statute of the Court of Arbitration, on a proposal of that Court.

6. The Court of Arbitration shall adopt its rules of procedure within the same period.

ARTICLE 52

The Association Council may make any useful recommendation for the purpose of facilitating contacts between the Community and the representatives of the various trades and professions of the Associated States.

General.

ARTICLE 58

1. The Association Council shall be informed of any request made by a State for accession to or association with the Community.

2. There shall be consultations within the Association Council on any request for association with the Community made by a State which has an economic structure and production comparable to those of the Associated States if the Community, after examining the said request, has laid it before the Association Council.

3. The agreement of association between the Community and any State covered by the previous paragraph may provide for the accession of that State to the present Convention. That State shall then enjoy the same rights and be subject to the same obligations as the Associated States. Provided always that the agreement which associates it with the Community may determine the date on which certain of these rights and obligations shall become applicable to it.

Such accession shall not adversely affect the advantages accruing to the Associated States which are signatories to this Convention from the provisions relating to financial and technical co-operation.

ARTICLE 59

This Convention shall be concluded for a period of five years from the date of its entry into force.

Source: E.E.C. and the African Associated States: The Convention of Association, distributed for the Royal Institute of International Affairs, London, Oxford University Press, 1963.

ANNEX DRELEVANT ARTICLES OF THE GENERAL AGREEMENT ON
TARIFFS AND TRADE, 1947

ARTICLE I

General Most-Favoured-Nation Treatment

1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

2. The provisions of paragraph 1 of this Article shall not require the elimination of any preferences in respect of import duties or charges which do not exceed the levels provided for in paragraph 4 of this Article and which fall within the following descriptions:

- (a) Preferences in force exclusively between two or more of the territories listed in Annex A, subject to the conditions set forth therein;
- (b) Preferences in force exclusively between two or more territories which on July 1, 1939, were connected by common sovereignty or relations of protection or suzerainty and which are listed in Annexes B, C and D, subject to the conditions set forth therein;
- (c) Preferences in force exclusively between the United States of America and the Republic of Cuba;
- (d) Preferences in force exclusively between neighbouring countries listed in Annexes E and F.⁽¹⁾

(1) The GATT Annexes referred to in Article I list Commonwealth countries, members of the French Union, and other countries benefitting from a preferential system in 1947.

3. The provisions of paragraph 1 shall not apply to preferences between the countries formerly a part of the Ottoman Empire and detached from it on July 24, 1923, provided such preferences are approved under paragraph 5 of Article XXV, which shall be applied in this respect in the light of paragraph 1 of Article XXIX.

4. The margin of preference on any product in respect of which a preference is permitted under paragraph 2 of this Article but is not specifically set forth as a maximum margin of preference in the appropriate Schedule annexed to this Agreement shall not exceed:

- (a) in respect of duties or charges on any product described in such Schedule, the difference between the most-favoured-nation and preferential rates provided for therein; if no preferential rate is provided for, the preferential rate shall for the purposes of this paragraph be taken to be that in force on April 10, 1947, and, if no most-favoured-nation rate is provided for, the margin shall not exceed the difference between the most-favoured-nation and preferential rates existing on April 10, 1947;
- (b) in respect of duties or charges on any product not described in the appropriate Schedule, the difference between the most-favoured-nation and preferential rates existing on April 10, 1947.

In the case of the contracting parties named in Annex G, the date of April 10, 1947, referred to in sub-paragraphs (a) and (b) of this paragraph shall be replaced by the respective dates set forth in that Annex.

ARTICLE XXIV

Territorial Application - Frontier Traffic - Customs Unions and Free-trade Areas

4. The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary

agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

5. Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; Provided that:

- (a) with respect to a customs union, or an interim agreement leading to the formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;
- (b) with respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement, as the case may be; and

- (c) any interim agreement referred to in sub-paragraphs (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.

6. If, in fulfilling the requirements of sub-paragraph 5(a), a contracting party proposes to increase any rate of duty inconsistently with the provisions of Article II, the procedure set forth in Article XXVIII shall apply. In providing for compensatory adjustment, due account shall be taken of the compensation already afforded by the reductions brought about in the corresponding duty of the other constituents of the union.

7. (a) Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the CONTRACTING PARTIES and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.

(b) If, after having studied the plan and schedule included in an interim agreement referred to in paragraph 5 in consultation with the parties to that agreement and taking due account of the information made available in accordance with the provisions of sub-paragraph (a), the CONTRACTING PARTIES find that such agreement is not likely to result in the formation of a customs union or of a free-trade area within the period contemplated by the parties to the agreement or that such period is not a reasonable one, the CONTRACTING PARTIES shall make recommendations to the parties to the agreement. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations.

(c) Any substantial change in the plan or schedule referred to in paragraph 5(c) shall be communicated to the CONTRACTING PARTIES, which may request the contracting parties concerned to consult with them if the change seems likely to jeopardize or delay unduly the formation of the customs union or of the free-trade area.

8. For the purposes of this Agreement:

(a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that

- (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,
- (ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;

(b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

ARTICLE XXXV

Non-application of the Agreement between particular Contracting Parties

1. This Agreement, or alternatively Article II of this Agreement, shall not apply as between any contracting party and any other contracting party if:

- (a) the two contracting parties have not entered into tariff negotiations with each other, and
- (b) either of the contracting parties, at the time either becomes a contracting party, does not consent to such application.

2. The CONTRACTING PARTIES may review the operation of this Article in particular cases at the request of any contracting party and make appropriate recommendations.

TRADE AND DEVELOPMENT

ARTICLE XXXVI

Principles and Objectives

8. The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties.

Source: Text of the General Agreement, as in force on 1 March 1969, reprinted from - Kenneth W. Dam, The GATT Law and International Economic Organization, Chicago, University of Chicago Press, 1970. pp. 390 - 444 passim.

ANNEX EGENERALIZED SCHEME OF PREFERENCES

Tariff Preferences in favour of Developing Countries.

1. Submission by the European Economic Community.

In transmitting to the UNCTAD the attached revised offer concerning generalized preferences, the European Economic Community wishes to confirm that the offer is made on the assumption that all the main industrialized countries of the O.E.C.D. will take part in the system of preferences and will make comparable efforts.

It is also confirmed that the Community's offer is subject to possible modifications following the consultations which the Community is obliged to hold with some of its Associated countries, in accordance with the provisions of the Association agreements.

I. - MANUFACTURES AND SEMI-MANUFACTURES (Chapters 25 to 99)

A

- As a general rule (1) preferential treatment will be given to all industrial manufactures and semi-manufactures in Chapters 25 to 99 of the Brussels Nomenclature originating in the developing countries;
- preference will take the form of exemption from Customs duties;
- preferential imports will be effected up to ceilings in value terms to be calculated for each product on a basis common to all products;
- in order to limit the preferences granted to the more competitive developing country or countries and to reserve a substantial share for the less competitive preferential imports of a given product from a single developing country should not as a general rule exceed 50 per cent of the ceiling fixed for that product.

(1) The phrase "as a general rule" implies that a very limited number of exceptions might be introduced in the light of consultations to be held with the O.E.C.D. Member countries.

Annual ceilings will normally be calculated in accordance with the following formula: c.i.f. value of imports for 1968 from beneficiaries under the system (basic quota) plus 5 per cent of the c.i.f. value of imports from other sources (supplementary quota).

Subject to improvements in the basis of calculation after several years of operation, the basic quota will be a fixed amount corresponding to imports in a reference year. The supplementary quota will be variable and recalculated annually on the basis of the latest available figures without, however, resulting in a reduction in the ceiling.

B

For cotton textiles covered by the long-term Agreement, preferences in the form of ceilings for duty-free imports calculated according to the formula under A above will be granted to countries which are beneficiaries under the system of generalised preferences and signatories to the long-term Agreement, for the duration of that Agreement.

Preferences may also, however, be granted for the same period, in accordance with terms and procedures to be agreed bilaterally, to countries which are beneficiaries under the system of generalised preferences but not signatories to the long-term Agreement, which give similar undertakings vis-a-vis the Community to those given in the long-term Agreement.

C

For coir and jute products, Customs exemption is also envisaged under specific measures to be arranged with the exporting developing countries.

II. - PROCESSED AGRICULTURAL PRODUCTS

The E.E.C. will grant tariff preferences for the processed agricultural products in the list transmitted to the UNCTAD on 15th November, 1969 and for the products in the list annexed hereto. The preferential rate for each product is indicated in the list.

III. - SAFEGUARD MECHANISMS AND ESCAPE CLAUSE.

For industrial manufactures and semi-manufactures, the safeguard mechanism is the direct result of the system chosen by the Community (predetermined import ceilings). On the other hand, for processed agricultural products, an escape clause will apply.

2. Submission by the United States.

The U.S. is prepared to participate, subject to Congressional approval, in a system of tariff preferences for developing countries, which should be liberal and should confer the maximum range of benefits on the developing countries. We consider that all the major developed countries must participate in the system and implement preference schemes which are harmonized as much as possible and can be expected to yield comparable results.

The U.S. proposal contains the following elements:

1. Preferential duties set at zero.

2. Preferences granted on:

(a) manufactured and semi-manufactured products in BTN Chapters 25 - 99, excepting only textiles, shoes, and petroleum products. (A list of the exceptions by TSUS - Tariff Schedules of the United States - item numbers is attached as Annex I.)

(b) a selective list of primary products in BTN Chapters 25 - 99. (A list by TSUS number of products which the U.S. considers to be primary products is attached as Annex II. A positive list of the primary products to be granted preferences is attached as Annex III.)

(c) a selective list of agriculture and fishery products in BTN Chapters 1 - 24. (A positive list of such products is attached as Annex IV).

3. A simple scheme, without ceilings on preferential imports, relying on the standard escape clause and adjustment assistance as safeguards for domestic industry.

4. A temporary scheme, i.e. not more than ten years, which would not constitute a binding commitment and would not impede future tariff reductions on a most-favoured-nation basis.

5. Developing countries which receive special preferences in developed country markets for products covered by the scheme would be excluded from preferences. However, if adequate assurances are provided that these special preferences would be phased out within a reasonable period of time, the developing countries concerned could be granted preferences from the outset.

6. Developing countries which grant reverse preferences to developed countries would be excluded from preferences. However, if such developing countries provide adequate assurances that the reverse preferences would be phased out within a reasonable period of time, they could be granted preferences from the outset.

Source: UNCTAD, TD/B/AC5/34.
EEC: Add 1. 19 September 1970.
USA: Add 5/Rev.1. 24 September 1970.

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