In 1999, the European Community had contractual and reciprocal bilateral agreements with 22 countries and contractual and nonreciprocal bilateral agreements with 77 countries (WTO, Trade Policy Review: The European Union, 2000). The EC is the direct source of 40 percent of all the preferential trade agreements (PTAs, which can be customs unions or free trade areas) notified to the WTO, and because the EFTA and Central European countries have duplicated the EC’s approach, the EC was (and still is) the direct or indirect source of two-thirds of the PTAs in the world. ¹

Future EC policy in these matters—and the positive or negative impact of these PTAs on the EC’s willingness to reduce trade barriers at the multilateral level—are thus essential for the WTO. It is all the more the case because the EC is the only PTA (along with the EFTA) for which there is convincing evidence of trade diversion on both the import and export sides, with the EC propensities to import and export significantly lower in 1995–96 than in 1980–82 (Soloaga and Winters 1999a, 1999b). These results suggest that the EC may have imposed a welfare cost on the rest of the world.

¹ In this chapter, the “Central European countries” are the 10 countries that signed a “Europe Agreement”: Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia. The “Balkan countries” are Albania, Bosnia-Herzegovina, Croatia, Macedonia, and the Federal Republic of Yugoslavia. The “Eastern European countries” are all the successor states of the former USSR (except the three Baltic states) located on the European continent.
In April 1997, the Community put on hold all the existing projects of new discriminatory agreements (because PTAs are discriminatory by definition, PTAs and discriminatory agreements are treated as synonymous in this chapter), revealing a growing political fatigue with respect to such an approach. The pause ended with the signing of the framework agreement with Mexico in December 1997. Since then, negotiations with South Africa and Mexico have been concluded in March 1999 and January 2000, respectively, but no major project with the United States, Mercosur, or Asian countries has gone very far (though none has been officially abandoned). The renewal of the Convention with the African, Caribbean, and Pacific countries (ACP) seems more a painful but inescapable burden imposed on the EC by the past than a free choice.

It is interesting that the texts released by the three European institutions for the Seattle WTO Ministerial are very shy on regionalism. The Council text does not refer to regional or preferential agreements—it does not even once use the term “preferences.” The Parliament text mentions the term only once, in the context of the trade and labor issue (see chapter 5). The Commission text uses the term “regional” (rather than “preferential” or “preference”) in four contexts: investment, trade facilitation, trade and labor issues, and the erosion of the preference margins granted by the EC to developing countries because of the WTO global liberalization process.

In this context, a few dominant themes emerge: (1) continuing EC support for certain of its traditional trade relations, in particular the agreement with the ACP states and the Generalized System of Preferences; (2) several references to “special and differential treatment” of developing countries; (3) attention to the least developed countries (LDCs), in particular by proposing a joint commitment from all industrial countries and the most advanced developing countries (e.g. South Korea or Singapore) to grant tariff-free treatment by 2003 to “essentially” all products exported by LDCs; and (4) EC commitment to support institutional capacity-building in developing countries (both on domestic topics such as competition policy and on international issues such as trade facilitation, implementation of certain Uruguay Round commitments, future trade negotiations, etc.).

Is this short and relative pause a first sign that the EC “addiction to discrimination” (Wolf 1994) will decline over the next decade (while changing its forms, as underlined by Brenton 2000)? Sustained EC activity on discriminatory agreements during the coming decade will depend on two sources, which will be examined in more detail in this chapter, with the help of the framework described in box 6.1. From the demand side (hence focusing on the cost-benefit analysis of EC-related PTAs for EC partners), to what extent have the existing agreements been beneficial to current EC partners—a factor determining the attractiveness of PTAs with the EC for countries having not yet negotiated such agreements? From the supply side (hence focusing on the cost-benefit analysis of PTAs for the EC itself), do new agreements exist that the EC would prefer to WTO deals because
Box 6.1 A brief overview of the literature on preferential trade agreements

This chapter often refers to the doubts raised in the economic literature about the wisdom of preferential trade agreements (PTAs; e.g., see de Melo and Panagariya 1993, Baldwin 1994, Winters 1996, Bhagwati and Panagariya 1996, and World Bank 2000).

This box briefly describes the main headings used in the chapter to present the pros and cons of preferential trade agreements.¹

First, economic analysis reveals the “static” costs and benefits of PTAs. Costs from trade diversion (producers from PTA partners are substituted for more efficient producers located in the rest of the world, because of the discriminatory reduction of trade barriers) can offset (and more) gains from trade creation (producers from PTA partners are substituted for relatively inefficient domestic producers). This analysis has three useful corollaries for the chapter: (1) PTAs may get voted in precisely when trade diversion is the dominant force (trade diversion makes PTAs more palatable to domestic uncompetitive industries than multilateral free trade). (2) When a PTA is between a high-tariff and a low-tariff country, losses from the PTA to the former can be large, a situation that may be worsened if the low-tariff country is the dominant economy, as is often the case for PTAs with the EC. (3) A PTA member that depends on tariffs for revenue may increase its tariffs on imports from non-PTA countries to compensate for its PTA-caused tariff revenue losses—hence exacerbating the risks of trade diversion.

Second, PTAs could provide three major types of “political” costs and benefits: security (each PTA partner becomes a member of a larger economic area), credibility (each PTA member locks its own trade policy into an international treaty), and insurance (each PTA member locks in the PTA partner trade policy). Many observers of PTAs are satisfied with the possible existence of these benefits. They implicitly consider that, if PTAs exist despite likely net static costs, it should be because of political benefits. This approach is not acceptable; political benefits must be empirically assessed, and compared with the alternative political benefits to be drawn from the WTO system.

Third, PTAs could bring “dynamic” costs and benefits related to changes in production location and investment patterns, either by decreasing trade-related transaction costs (e.g., through the mutual recognition of product standards or service regulations) or by generating foreign direct investment and associated technology spillovers. However, such positive effects can be counterbalanced by new costs. For instance, because they are discriminatory, PTAs require rules of origin that undoubtedly make customs procedures more complex and costly. Foreign direct investment may increase only to avoid external trade barriers (tariff jumping) raised by PTAs.

PTAs are often based on a “hub and spokes” system (e.g., with the EC as the large, dominant economy—the hub—and the EC partners as the spokes), which may make it more expensive to locate investments in the spoke countries than in the hub country. In other words, such a system favors the EC as the investment location to the detriment of its partners. Similarly, mutual-recognition agreements in hub and spokes PTAs may improve market access for the hub more than for the spokes.

¹ This brief survey cannot do justice to theoretical counterarguments, such as welfare-enhancing trade diversion or nondiscriminatory spillover effects of reduced frictional costs. However, these aspects do not change the main thrust of the survey: economists’ reluctance to support discriminatory trade agreements.

*(box continues next page)*
they would provide a cost-benefit balance better than, or at least comparable to, the balance that WTO deals could offer?

The chapter argues that, during the coming decade, the EC may slowly shift away from the discriminatory approach. The first section below (on ACP and GSP countries) and the second section (on Central European, Mediterranean, and Balkan countries) suggest that existing PTAs have been disappointing for most EC partners—inducing these countries to look either for EC membership or, if they cannot, for WTO-friendly alternatives. The third section looks at potential PTAs that the EC could envisage with the United States, and with Latin American, Asian, or Eastern European countries; it suggests that most of these agreements would require structural adjustments from the EC comparable to adjustments for WTO rounds, without offering to the EC the same trade-offs in market access and economic benefits. This is because all the possible PTAs of some scale for the EC will, almost inevitably, include large and serious competitors of EC producers in agriculture, industry, or services that have been left outside by the current web of EC discriminatory agreements.

The fourth section of the chapter examines an often neglected dimension of the “regionalism versus multilateralism” debate, namely, the use of the dispute settlement mechanisms offered by these two alternatives. It focuses on the EC’s use of the WTO mechanism, for which there is much more information. The fifth section concludes by suggesting a few ideal ways in which EC trade policy should evolve.

It would be surprising for the EC to completely and rapidly abandon a bilateral approach that it has cherished so much and for so long. PTAs have been seen by the Commission as a proxy for a foreign policy that has been (and still is) out of its reach, and by EC member-states as a way to maintain or reinforce their own political influence on certain non-EC countries—almost leading each member-state to get “its” own EC PTAs by trading them for comparable requests from other member-states. Rather, for the foreseeable future, the EC may simply try to “rationalize” its web of existing agreements, at a pace largely determined, as in the past, by political considerations. One should not forget that the Conven-
tions with the African, Caribbean, and Pacific countries were a reaction to the independence of these countries: the EC Generalized System of Preferences was a response to the movement among developing countries of the 1960s; the agreements with the Central European countries came in the aftermath of the fall of the Berlin Wall; and the agreements with the Mediterranean and Balkan countries countered the fear of conflicts close to European borders.

EC Nonreciprocal Discrimination: ACP Conventions and the GSP Scheme

The EC’s addiction to discrimination was born with the Treaty of Rome. In 1957, three EC member-states were colonial powers on the verge of granting independence to their remaining colonies. To face this change, the Treaty of Rome offered to these colonies, once independent, the possibility of being “associated” with the Community. The treaty draft contained a framework—a single free trade agreement between the Community on the one hand and, on the other hand, a unique free trade area for all future associated countries—that was likely to minimize distortions and costs from such an association (Grilli 1993).

This initial framework was never implemented. It limited too much both the inward-looking development policies fashionable among newly independent countries and the vested interests of former colonial powers. As a result, the First Yaoundé Convention—signed in 1963 between the EC and the 18 newly independent countries—inaugurated the quite different system of hub and spokes. The EC became the hub of 18 de facto bilateral, nonreciprocal free trade agreements, one with each associated ACP country. Almost concomitantly, in 1965, developing countries were able to impose the adoption of GATT Section IV, allowing a “special and differentiated treatment” of these countries with a nonreciprocal “generalized system of preferences.” The EC GSP became the source of a second set of spokes around the EC hub. Box 6.2 briefly presents these two agreements; the rest of this section examines the benefits for EC partners and the resulting problems to be solved during the coming decade.

What Net Gains for ACP and GSP Beneficiaries?

At first glance, the ACP Conventions look favorable for EC trading partners, and they may have been so until the 1990s. However, EC preferences to ACP states are evaporating (European Commission 1999a) for three reasons. First, preferential margins for EC tariffs imposed on ACP exports and non-ACP exports are decreasing because EC MFN tariffs are decreasing. In 1996, the average preferential margin granted to the ACP states
Box 6.2 The ACP and GSP agreements

The trade regime of the African, Caribbean, and Pacific (ACP) Conventions (Yaoundé I and II, followed by Lomé I to IV and, since June 2000, by Cotonou) provides for free access (no duty, quantitative restriction, or measure having equivalent effect) to EC markets for all industrial products originating from the ACP states (77 ACP states have signed the Cotonou Convention). Preferential access to EC markets was granted for four farm products (sugar, bananas, beef, and rum). For a few other farm products, preferential reductions were granted on border charges imposed by the EC Common Agricultural Policy. Rules of origin (possible cumulation, value-added threshold, tolerance about nonoriginating materials) are more favorable for the ACP countries than for the signatories to any other EC discriminatory trade agreement. The safeguard clause is also more limited than in other EC regional agreements (to the point that, in practice, it might be difficult to enforce).

This trade component of the ACP Conventions was easily accepted, all the more because it was not seen as the most valuable part of the Conventions. The ACP countries valued much more the aid regime based on partnership between donors and recipients (hence, without much conditionality) and the commodity price stabilization scheme (Stabex).

In 1971, the EC introduced its own Generalized System of Preferences (GSP), and renewed it several times. Contrary to its direct predecessor (which made wide use of tariff quotas), the current GSP (1995–2004) grants preferences in the form of tariff reductions, but these preferences are subject to “modulation,” “graduation,” and “incentives.”

Modulation means that tariff reductions vary by product according to the “sensitivity” of the product for EC producers. Reductions are restricted to 15 percent for “very sensitive” products (textiles, clothing, and ferro-alloys); to 30 percent for “sensitive” products (electronics, cars, and chemicals); and to 65 percent for “semi-sensitive” products. As a result, tariff elimination is limited to “nonsensitive” products. In other words, modulation implies that the EC GSP grants limited benefits to exports for which developing and emerging-market countries tend to have comparative advantages.

Graduation means that tariff reductions are a function of economic and trade features of the beneficiaries, giving least developed countries preferences close to those they receive under the ACP Convention. Conversely, since 1998, EC trading partners with a GNP per capita higher than roughly $8,200 in 1995 have not been able to benefit from the EC GSP. This clause has eliminated Hong Kong, South Korea, and Singapore from GSP coverage. Last but not least, foreign exporters having a share larger than 25 percent of EC imports of a product are not eligible for the GSP tariff reduction associated with the product in question.

Incentives mean that GSP benefits can be “upgraded” (tariff reductions can be larger) if the EC partner fulfills certain conditions regarding environment and labor standards (see chapter 5). This EC initiative to link trade and labor issues has been badly received. As of July 1999, only Moldova had requested the benefit of these provisions.

Additional tariff reductions have been granted to certain South and Central American countries with the “Drug GSP” (1990) or “Hurricane GSP” (1999) to reward antidrug policies or to help countries facing natural disasters. These refinements have met strong opposition among EC partners because they discriminate among developing countries, as is best illustrated by Brazil’s request for a WTO panel on the Drug GSP.
was 3.6 percent with respect to the MFN tariff, and 2.5 percent with re-
spect to the GSP regime. In 2000, these margins were reduced to 2.9 and 2
percent (with more than 80 percent of EC industrial imports from ACP
countries being duty free, on an MFN basis).

These smaller preferential margins are also becoming less uniformly
spread over the range of products. In industry, only chemicals, footwear,
and textiles (one-fourth of ACP exports) will still bring substantial prefer-
ences. In agriculture, half the ACP exports will lose their preferences, par-
ticularly coffee and cocoa (the latter having, in addition, to face increased
competition from vegetable fats following the new EC directive on choco-
late, see chapter 4), whereas the other half will keep a preferential margin
of 10 percent.

A second, more important, source of preference decrease will flow from
the elimination, scheduled for 2005, of the indirect protection granted to
relatively inefficient ACP textile producers by EC Multi-Fiber Agreement
(MFA) restrictions imposed on more efficient producers from the rest of
the world.

A third source of preference decrease is the commodity protocols that
have generated noticeable transfers of EC tariff revenues to ACP produc-
ers—to the point of artificially inducing certain African countries to invest
in banana production, and to try to compete with highly competitive
Caribbean producers, despite the long-term negative impact of such crops
on African land and water resources. These protocol preferences have
generated exports worth roughly €1,600 million: €850 million for sugar,
€400 million for bananas exported by 12 beneficiary ACP states,
€225 million for ACP rum producers, and the rest for beef. However, in
2000, preferences on rum exports were discontinued, and those on ba-
nanas were shifted to a new, indirectly less favorable, legal regime (see
below and appendix A, case 19). Those on beef, however, depend on the
EC intervention price, which has to be reduced by 20 percent in ac-
cordance with the Berlin Summit (see chapter 4), a change that may amplify
the steady decline of the quota fill rate (from 80 percent in the late 1980s
to 50 percent in the late 1990s).

Last, the EC has granted trade preferences to other countries, in par-
ticular Mediterranean states, Mexico, and South Africa. The new trade
agreements with these countries offer conditions broadly equivalent to
ACP Conventions for market access to the EC for key products (fish, fruit,
vegetables, tobacco, textiles, and clothing).

Despite their much easier access to EC markets in the past decades, very
few ACP countries have had a good growth and trade record since 1965.
The key reason is that ACP countries have been very reluctant to liberal-
ize their own economies; periods of liberalization have been rare and short,
and they have almost invariably been followed by periods of reprotection
At first glance, this conclusion suggests that the ACP Conventions have little to do with ACP bad performance, and it underlines the “unimportance of being preferred” (Davenport 1992; McQueen 1998). Such a view is supported by the fact that the 29 percent of ACP exports that have benefited from substantial preference margins (defined as larger than 3 percent in 1996) increased by only 62 percent in volume during the decade 1988–97, relative to 80 percent for the developing countries benefiting only from the GSP. Only five ACP states out of 70 have shown a growth rate higher or equal to the average growth rate of developing countries, and even this success seems very fragile. For three of these five ACP states (Jamaica, Madagascar, and Mauritius), it is based on exports of textiles and clothing; exports from developing-country competitors of these ACP states are subjected to high trade restrictions; and the major exports of the two other ACP states (Kenya and Zimbabwe) consist of flowers and fruit, with all the risks associated with the CAP (for fruit in particular).

One can go further and argue that the nonreciprocity approach of the ACP Conventions has been instrumental in the fundamentally flawed design of the trade policies of the ACP states. Because ACP exporters were certain to get free access to EC markets, they did not have to lobby their own governments to open their home economies as a quid pro quo for access to foreign markets. In sum, the ACP Conventions have systematically destroyed the domestic political engine (the export lobbies) behind trade liberalization.

This basic problem has been exacerbated by the fact that, at the dawn of independence, subsidiaries of EC firms constituted the core of the “modern” industrial sector in ACP countries, and became the major beneficiaries of growing ACP protectionism—enjoying considerable monopoly rents when things were still going well, and benefiting from subsidies granted by the ACP host countries (and often financed by EC member-state aid funds) when things turned bad. Last, the wave of nationalizations in many ACP countries has often been more useful for the remaining subsidiaries of EC firms than harmful to them. Nationalizations provided the political justification for high trade barriers and high domestic prices, playing the role of “rent-umbrellas,” as is best illustrated by the diverging fate of the EC and ACP shipping companies under the cartels organized by the UNCTAD Conference Liner Code.

Turning to the GSP, its potential preferences have been more limited than those under the ACP Conventions. Modulation allows for keeping still-high GSP tariffs on very sensitive or sensitive products because the MFN tariffs on these goods (e.g., textiles and clothing) are generally very high. Graduation introduces a discriminatory treatment between GSP beneficiaries; it excludes the most developed and the largest exporters among the potential beneficiaries (e.g., it has excluded roughly 80 percent of South Korea’s or Singapore’s industrial exports and still excludes 55 percent of Chinese industrial exports from EC GSP coverage), de facto limiting the GSP to small developing economies. Last, the complicated structure of the
GSP makes its implementation costly, in particular because of complex rules of origin—hence precisely hurting these small ACP partners. As a result, the GSP preferences have been very small in recent years (Hallaert 2000). For instance, if one excludes temporarily the impact of the graduation mechanism, the average GSP tariff on industrial goods in 1997 was 2.7 percent—half the 5.1 percent average EC MFN tariff and a differential small enough to be easily annihilated by the costs (estimated to be 3 percent of prices; OECD 1998c) of complying with rules of origin. Taking into account graduation (which forces us to look at specific countries) worsens the picture: in 1997, the average GSP tariff on EC industrial imports from China was 3.6 percent, almost three-quarters of the EC MFN tariff, ironically it was 3.2 percent on industrial imports from Singapore.

1970s and 1980s: The EC “Pyramid of Preferences”

This brief survey suggests that the ACP and GSP schemes have not provided large benefits (if any) for EC partners because they reinforced the choice of a protectionist policy (in the ACP case) or offered in fact very limited “preferences” to these countries (in the GSP case). Nevertheless, despite their limitations, these two schemes were used during the 1970s and 1980s as benchmarks by the EC when granting preferences to other countries—leading to an elaborate “pyramid of preferences” (Mishalani et al. 1981) consisting of six main layers.

At the bottom of the pyramid, the first layer consisted of centrally planned economies, generally not GATT members, which faced “conventional” or bilaterally negotiated EC tariffs (often much higher than EC MFN tariffs), as well as many quantitative restrictions, generally defined at the member-state level—and hence subject to intra-EC trade restrictions under Article 134 (ex 115). The second layer consisted of EC partners under MFN status—essentially the non-EC OECD countries. Imports from these countries were subject to EC MFN tariffs, and to relatively few nontariff barriers, except imports from Japan, which were often subject to voluntary export restraints (introduced during the process of the Japanese accession to GATT).

The third through sixth layers consisted of countries benefiting from EC “preferences.” The third layer included the developing countries under the EC GSP. The fourth layer consisted of Mediterranean countries that could not have been included in the ACP scheme because they were already independent when the EC was founded, and that had not been left at the GSP layer because of their deep political ties with certain EC member-states. Exports from these countries enjoyed roughly GSP tariff reductions, but they were subject to fewer EC quantitative restrictions than those imposed on GSP partners (e.g., clothing quotas were imposed on Mediterranean exports, but only by one or two EC member-states, and for
less than a handful of clothing categories). The fifth layer consisted of the ACP countries. Last, at the top of the pyramid were the EFTA countries—the only group of countries under reciprocal preferences with the EC, with a free trade area for industrial goods (although subject to antidumping and antisyubsidy measures), but also with severe limits on farm trade and almost no provision for services.

In 1989, this pyramid collapsed because the bilateral trade agreements between the EC and the Central European countries catapulted those countries from the lowest layer of the pyramid to almost the highest. (The reshuffling of the upper layer between EFTA, EEA, and new members has not affected the pyramid per se, but has underlined its volatility.) Because any “preference” granted to a trading partner is, by definition, a discrimination against another trading partner, the upgrading move of the CECs in the pyramid deteriorated the relative situation of all the other EC trading partners—generating bitter requests from ACP, GSP, and Mediterranean countries to “upgrade” their status.

However, there are remnants of this past pyramid of preferences. As shown by table 6.1, tariffs decline according to trade status with the EC—from MFN to the GSP, to the various free trade agreements with the EC, to least developed country status, to Lomé-ACP status. This conclusion deserves three remarks (in addition to the fact that table 6.1 relies on 16 million tariff records—a good indicator of the complexity of the EC pyramid of preferences). First, a country can often choose the lowest rate for each product from the various preferential tariffs for which it is eligible—meaning that there are substantial redundancies among all the various EC schemes for trade preferences. Second, tariff preferences are small in agriculture and preferential tariffs are relatively high. Third, the GSP is not the

<table>
<thead>
<tr>
<th>Product</th>
<th>MFN bound</th>
<th>MFN applied</th>
<th>GSP + MFN</th>
<th>FTA + MFN</th>
<th>LDCs + GSP + MFN</th>
<th>Lomé + MFN</th>
</tr>
</thead>
<tbody>
<tr>
<td>All products</td>
<td>7.0</td>
<td>6.9</td>
<td>4.9</td>
<td>3.5</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td>Agricultural products(a)</td>
<td>17.4</td>
<td>17.3</td>
<td>15.7</td>
<td>16.7</td>
<td>10.3</td>
<td>10.3</td>
</tr>
<tr>
<td>Nonagricultural goods(b)</td>
<td>4.6</td>
<td>4.5</td>
<td>2.3</td>
<td>0.5</td>
<td>0.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>

FTN = free trade area
GSP = Generalized System of Preferences.
LDC = least developed countries
MFN = most favored nation

\(a\) As defined in annex I of the WTO Agreement on Agriculture.
\(b\) The rest of the products.

best status for developing countries, a point crucial for the reform of the ACP Conventions.

What Future for ACP and GSP Schemes?

In February 2000, the Lomé IV Convention expired and the EC and the 78 ACP states concluded negotiations on the Cotonou Partnership Agreement (PA) covering five aspects: political issues (peace-building, human rights, democracy, rule of law, and immigration), institutional reforms and involvement of the “civil” society, development strategies (with a focus on poverty reduction, cultural development, and gender equality), trade policy and trade-related issues (competition policy, standardization, trade and environment, labor standards, health safety), and financial aid.

The Cotonou PA trade component has four major features. (1) It will last only eight years compared to 20 years for the nontrade aspects of the PA. (2) During this eight-year period, the EC will basically continue to apply the nonreciprocal Lomé IV Convention, except for the Lomé banana protocol (to be replaced by new provisions in the context of the new EC banana trade regime, see appendix A, case 19). (3) During the same period, the EC will negotiate new trade agreements with 77 ACP states. (4) The PA trade component does not apply to the largest African economy, South Africa, which signed a special trade agreement with the EC in October 1999, raising risks of eroding the PA benefits for the other ACP states, in particular Botswana, Lesotho, Namibia, and Swaziland (Akinkugbe 2000).

If the EC agreement with South Africa has a time frame that is relatively similar to the PA trade component (a transitional period of 10 years for the EC and 12 years for South Africa), its structure is shaped by GSP status. Tariffs will be removed according to product categories defined by sensitivity, as in the GSP. On the whole, EC tariffs are expected to be removed from almost all South African industrial exports but from only 61 percent of South African agricultural exports (a source of severe friction during the negotiations), whereas South African tariffs are expected to be eliminated or reduced on 80 to 85 percent of farm and industrial imports from the EC.

The new PA trade regime with ACP States will have to be compatible with WTO rules. The Lomé Convention infringed on GATT Article I on nondiscrimination because it covered only certain developing countries whereas GATT Section IV allows discrimination only in favor of all developing countries; and it could not be considered an exception under GATT Article XXIV because it was non-reciprocal, contrary to a customs union or a free trade area.

Moreover, if the Lomé sugar protocol got a waiver at the end of the Uruguay Round (although it could still possibly be contested by certain producers, e.g., Brazil), this was not the case for the beef protocol (because traditional ACP exporters are not “substantial suppliers”), and above all,
for the banana protocol. The three GATT and WTO dispute cases on bananas have revealed how much the whole Lomé Convention has progressively become the hostage of EC banana trade policy—with the hostility against Lomé increasing among non-ACP developing countries producing bananas (the motives behind the EC banana policy have little to do with the ACP Conventions; see appendix A, case 19). The legal risks generated by the EC’s inability to overhaul its banana policy obliged the EC to request a last waiver for the PA for the transitory period 2000–08 from its WTO partners (see appendix A, case 19).

As a result, the new ACP trade regime will be based on *reciprocity*, which conforms to GATT Article XXIV. Starting in 2008 and for a transitional period of at least 12 years (2008–20), ACP states will liberalize their own trade regimes with respect to EC exports, with strong possibilities of “backloading” this liberalization. If ACP states do not want to do so, they will benefit from the new SGP regime that the EC will announce in 2004; however, least developed countries (LDCs) can continue, if they wish, to benefit from the nonreciprocal access to EC markets under the “Everything but Arms” initiative (see the concluding section of this chapter). The 2000–08 preparatory period will thus prepare the ACP states for this crucial move to reciprocity. This shift (with a hotly disputed clause about the readmission by the ACP countries of their illegal emigrants to the EC) is the major reason for the huge financial package to be disbursed during the preparatory period: €13.4 billion in newly committed funds, plus €9.9 billion in resources not disbursed during Lomé IV and €1.7 billion from the European Investment Bank; that is, a total of almost €25 billion (in comparison, the GDP of all the ACP countries was estimated to be €200–250 billion in the late 1990s).

What will be the detailed structure and content of the new trade regime to be negotiated before 2008? Currently, the most fashionable proposal in Brussels is to create “regional economic partnership agreements” (REPAs) consisting of free trade agreements between the EC and ACP countries. The envisaged REPAs would be based on the free trade areas already existing between ACP countries: Caribbean Community (CARICOM), East African Cooperation (EAC), Southern African Development Community (SADC), Union douanière et économique de l’Afrique centrale (UDEAC), and Union économique et monétaire ouest-africaine (UEMOA).

A proposed alternative to REPAs could have been to apply the GSP status to ACP states, but this seems to have been abandoned—largely because it would have been costly for the 37 ACP “non-least developed countries” (non-LDCs), which represent three-quarters of ACP exports to

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2 The only exception to these legal uncertainties consists of the sugar tariff quotas, which have been included in the current access quotas under the Uruguay Agreement on Agriculture.
the EC; a margin of tariff preference of roughly 1.9 percent would have been lost, and losses related to the remaining product protocols would have been substantial for 22 non-LDCs (European Commission 1999b).3

The REPA-based proposal suggests two remarks. First, the shift of EC policy to reciprocity has been largely triggered by considerations external to the ACP states. As explained above, the EC has been unable (still is, despite the appearances) to change its banana trade policy quickly enough—fuelling the hostility against the ACP Conventions among non-ACP developing countries. Moreover, the EC has found it increasingly difficult to grant nonreciprocal preferences to ACP states, whereas Australia, Canada, the United States, and the APEC countries were receiving some privileged access to certain ACP states through initiatives such as the Free Trade Area of the Americas (Caribbean ACP states) or the US African Growth and Opportunity Act (Sub-Saharan ACP states).

Second, an examination of the three possible sources of costs and benefits from discriminatory trade agreements (see box 6.1) suggests that the envisaged REPAs are likely to generate net costs for the ACP states, for three reasons.4 REPAs are likely to generate large static costs, because they are unlikely to spur noticeable trade creation, but are likely to generate substantial trade diversion. By reducing their tariffs on EC goods, ACP states will transfer part of their corresponding tariff revenues to inefficient EC-based firms—because of the ACP states’ high MFN tariffs imposed on imports from the rest of the world (a sad situation, more so because the previous ACP Conventions transferred protectionist rents to inefficient subsidiaries of EC firms located in ACP countries).

Two additional forces may reinforce these static costs: (1) A PTA between two small countries (such as the ACP states) that also trade with a third large country (such as the EC) may harm the small net importing country whenever imports from the large country are subject to tariff and are necessary to clear the market of the small importing country—a typical situation for the LDC ACP states that will use the possible option to reject the reciprocity condition (remaining de facto under a trade regime close to the Lomé Convention) and will also pertain to PTAs between ACP states. (2) A PTA between two low-income countries tends to lead to income divergence and to put at risk the lowest-income country—a possibly frequent situation because REPAs include countries with noticeably different income levels (Venables 1999). Moreover, the REPA approach

3. ACP least developed countries could have been shifted to the GSP regime without too many problems, because the GSP and the Lomé regimes are close for this group of countries (see box 6.2).

4. What follows ignores the huge political difficulties of the REPA approach, namely, the fact that 25 ACP countries are not members of any PTA, and that the existing PTAs among ACP states are far from robust.
will be very costly for all the ACP budgets (tariff revenues represent 30 percent of a typical ACP public budget, with peaks up to 50 percent for Sub-Saharan countries), with additional distortions likely to favor “large” ACP countries (e.g., Ivory Coast or Kenya) relative to “small” ACP states pertaining to the same REPA—with the almost certain risk of generating political tensions.

Moreover, REPAs are unlikely to increase substantially the political benefits from discriminatory trade agreements (security and conflict management, credibility, and insurance), relative to those provided by past ACP Conventions. Finally, dynamic benefits from lower transaction costs due to regional agreements are at best dubious if one takes into account ACP administrative capabilities to manage complex rules of origin; and chances of getting rapidly dynamic benefits from increased foreign investment are slim in countries notorious for their sudden and frequent policy reversals.

In terms of pure reciprocity and discriminatory trade agreements, the EC initiative toward REPAs has major flaws. However, it may not be such a bad idea if recast using a conditionality-based approach, as will be suggested in the concluding section of this chapter.

EC Reciprocal Discrimination:
Central European, Mediterranean, and Balkan “Spaghetti Bowls”

In the early 1990s, EC discrimination shifted from a nonreciprocity to a reciprocity approach. Paradoxically, this shift was a reaction to the nonreciprocal and nondiscriminatory sweeping trade liberalizations undertaken by Czechoslovakia, Hungary, and Poland immediately after the fall of the Berlin Wall. These liberalizations brought rapid economic benefits to the three CECs; within a couple of years, their trade patterns changed dramatically, reflecting a return to trade flows based on comparative advantage (Kaminski, Wang, and Winters 1996; Hoekman and Djankov 1997a). They also brought a large—unanticipated then, still unrecognized today—political benefit to the three CECs. In particular, they forced an initially reluctant EC to abandon its old formula of “cooperation and trade” agreements with centrally planned economies and to dismantle its barriers on imports from CECs—in other words, they forced the EC to knock down its cherished pyramid of preferences.

The EC shift to reciprocal discrimination has been the source of roughly a hundred bilateral agreements in Europe alone, and this figure is rapidly increasing, with new agreements in the Balkans, and the replication of EC agreements by Turkey under the Customs Union Treaty with the EC (see table 6.2). All these agreements have the same general structure, but they differ in many details: product coverage, time frame, liberalization pace,
Table 6.2 The “spaghetti bowls” of European discriminatory trade bilateralism, 2000

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<tr>
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EEA = European Economic Area.
EA = Europe Agreement.
F = free trade agreement
Fs = free trade agreement with substantial exceptions (agriculture)
EEA = European Free Trade Area.
EFTA = European Free Trade Area.
BFTAs = Baltic Free Trade Area.
CEFTA = Central European Free Trade Area.
EC = European Community.
WTO = World Trade Organization.

Note: Boxes illustrate the membership of EFTA, CEFTA, and BFTA, respectively, with the general status in the diagonal cells.

Sources: Notifications to the WTO; EC, Official Journal.
and so on. The resulting “spaghetti bowls” (Bhagwati 1995) illustrate the emergence of a European “bilateralism” centered on the EC.

This section focuses on the EC’s relations with Central Europe, with three questions related to the Europe Agreements (EAs, described in box 6.3). Are there reasons to believe that EAs are costly for the CECs? If yes, what could the CECs do to reduce these costs? Could the CECs substantially influence EC multilateral trade policy before becoming full members of the Community? After having examined these points, the section concludes with a brief description of the discriminatory EC agreements with the Mediterranean and Balkan countries.
Are EAs Costly for the CECs?

From the CEC perspective, the balance of the static costs and benefits to be drawn from EAs is likely to be disappointing, for two reasons. (For a slightly more optimistic conclusion, see the analysis of the Poland-EC EA [World Bank 2000, 66–67]). First, the value of additional preferences granted by EAs to the CECs (the difference between the EC MFN rate and the EC zero rate granted to the CECs) has been limited because the CECs were already enjoying substantial access to EC markets for all nonsensitive products before the signature of EAs (under the GSP and the 1990–91 measures; see box 6.3). The only noticeable source of additional preferences attached to EAs has been the elimination or suspension of tariffs in 1997, and quantitative restrictions in 1998 on exports of textiles and clothing from the six original CECs.

The often-mentioned other source of additional preferences—the progressive introduction of a pan-European system of cumulation of rules of origin—is less clear. The pan-European system still has limits (described in chapter 4) that make it costly to manage, and that make it more difficult to assess the net impact of preferential rules of origin on trade creation and diversion. This net effect depends on several factors, e.g., the relative importance of traded intermediate versus final goods, the origin or use of these intermediate goods, etc., that play in opposite directions (Panagariya 1999b).

The second reason for likely static costs attached to EAs is the MFN trade policy of the CECs themselves. During the EA negotiations, all the CECs except Estonia increased their protection with respect to non-EC countries, sometimes very substantially (e.g., the Polish average industrial tariff increased roughly from 6 percent in 1991 to 18 percent in 1993). This protectionist drift was possible because all the CECs were not GATT or WTO members subject to the discipline of “bound” tariffs at the time of signing their Interim Agreement with the EC—the only exception being Czechoslovakia, which indeed has not increased its GATT-bound tariffs because it was the only Central European fully fledged GATT member be-

5. For the EC, the economic benefits and costs of EAs per se are small, for several reasons: The CECs are small markets for the huge EC economy; the value of the additional preferences granted by the EC to the CECs with EAs has been very limited and declining (EC MFN tariffs have declined with the Uruguay Round, the 1996 First Information Technology Agreement, the Customs Union with Turkey, the agreements with Mexico and South Africa, etc.).

6. From 1992 to 1998, EAs granted increasing “outward processing traffic” (OPT) quotas to CEC exports of textiles and clothing, which prepared for the 1997–98 liberalization. OPT quotas also have been beneficial to EC firms because their use was conditional on imports of raw materials or intermediate goods from the EC. In other words, OPT quotas have given EC firms powerful leverage to vertically integrate Central European producers for six years, and to reap the associated rents. The six initial CECs are Bulgaria, the Czech Republic, Hungary, Poland, Romania, and Slovakia.
fore signing the EA. If it reflected domestic pressures in each CEC, this protectionist drift was also fueled, in numerous instances, by pressures coming from EC member-states, the Commission, and firms (as is best illustrated by the car case; see appendix A, case 12).

By increasing their protection on imports from non-EC countries before or during the EA negotiations (and by continuing to do so since then, when possible, e.g., in agriculture, through discriminatory surcharges and other instruments), the CECs have substantially increased the value of the preferences that they grant to EC producers—and with it, the risk of trade diversion and the possibility of welfare costs. The still relatively high level of EC overall protection shown in table 2.1 suggests that a wide range of EC producers could be relatively inefficient by world standards—in other words, that trade diversion is not rare, all the more because CEC imports from the EC are large, often representing 40 to 60 percent of total CEC imports.

Static costs can be compensated for by political and dynamic benefits. However, the political benefits of EAs seem dubious. First, it is hard to see how EAs could have enhanced CEC security vis-à-vis the rest of the world, in particular the Soviet Union or Russia. The fact that the EC did not show any willingness to compromise on sensitive sectors, despite minute economic effects on the EC huge economy, was not precisely a signal of West European readiness to fight for the CECs, if necessary.

Second, the credibility of CEC economic reforms could have been enhanced by EAs, only if EAs were not accompanied by a reversal of the CECs’ initially open trade policy (see above) and only if CECs’ commitments would have been more credible when taken vis-à-vis the EC alone than when taken vis-à-vis a group of trading partners, including the EC. Such a condition—that “fewer cops are better than more cops”—would be convincing only if the EC had a better monitoring and retaliating system than its trading partners—a doubtful condition, if one takes into account the post-Uruguay Round tough dispute settlement regime. (The argument that dispute settlement schemes of PTAs are better than the WTO regime because they may give better access to private parties is highly debatable; such a possibility is not available in most PTAs, and the WTO dispute settlement regime is not totally impermeable to private parties.) Last, the EA component of insurance against EC trade practices was not very convincing either, after the EC antidumping regime was upheld and introduced several safeguard provisions were introduced in the EAs. Indeed, from 1990 to 1999, the CECs were accused by the EC of alleged dumping in 42 cases, compared to 106 cases during the 1980s (see appendix B).

Dynamic benefits from EAs are more difficult to assess. The available evidence suggests that the CECs that are most advanced in their accession negotiations are those with the largest exposure of their exports to EC technical regulations policy, and in particular to the New Approach (Brenton, Sheehy, and Vancauteren 2000). However, the discussion of the EC
system of technical regulations (see chapter 4) does not suggest that the EAs can be powerful enough to eliminate TR-related costs (those costs have been very imperfectly reduced within the existing Community).

The same observation can be made for liberalization in services. If increasing foreign investment in the CECs could provide large benefits (Baldwin, François, and Portes 1997), investment flows to the CECs have so far remained limited, except for Hungary since the mid-1990s and perhaps the Czech Republic since 1999. In 1997, the inward stock of foreign direct investment (FDI) amounted to, respectively, 35 and 23 percent of GDP in Hungary and the Czech Republic but 10 percent or less in the other CECs (preliminary estimates on FDI flows for 1998 do not dramatically change the picture) (UNCTAD 1999). Moreover, some large FDI inflows may have reflected costly investment diversion occurring behind high trade barriers (e.g., in the Polish car industry; see appendix A, case 12).

**EAs and CEC Accession to the EC**

In the volatile political environment of Central Europe in the early 1990s, Central European politicians focused on the immediate political benefits of trade agreements (e.g., the apparent legitimacy attached to signing EAs) while ignoring their delayed costs, to the extent that they were aware of such costs. When they began to realize EA deficiencies (with the probably excessive trade reallocation and the limit of EC political support), they started to negotiate discriminatory trade agreements between themselves in order to counterbalance EAs (see box 6.4).

But the *bilateral* feature of many of these intra-CEC agreements imposed (and still does) a strong limit on their capacity to reduce the costs of the hub and spokes regime generated by the EAs. This weakness of the intra-CEC approach can be explained by several factors. Certain factors are political and quite specific to the European situation, such as the CEC belief in a rapid accession of their countries to the EC. Other reasons are economic and quite generic to trade agreements between spokes; contrary to multilateral free trade, gains from discriminatory trade agreements flow from increased shares obtained in export markets, whereas costs are imposed by rents abandoned to inefficient producers located in partner countries. As a result, export lobbies in a spoke country focus on the large markets of the hub country, and concentrate their efforts on the risks of domestic protectionist measures in these markets. By contrast, they neglect spoke markets, and possible domestic protectionist reactions from the spoke countries.

Now that the EAs have been implemented and will last for a long time, how can the CECs reduce their costs? Of course, a first possibility is to accelerate the CEC accession process to the EC. Membership is likely to reduce static costs because it will reduce CEC MFN tariffs, and it could be
expected to increase dynamic benefits related to smaller transaction costs and larger foreign investment flows. However, this option does not depend on the CECs alone; it requires EC acquiescence at the very time the CECs threaten two powerful EC interest groups: farmers and poor EC regions.

It is thus not so surprising that the accession process has been very slow, as described in more detail in box 6.5 and table 6.3. As of April 2001, no negotiations on the difficult topics had taken place, although the process with the Czech Republic, Estonia, Hungary, Poland, and Slovenia (the so-called first wave, or “Luxembourg Group”, which also includes Cyprus) had been launched in December 1997 by the Luxembourg European Council (for details, see Mayhew 2000a). During the past two years, the CECs have completed their negotiating position papers on all the chapters for negotiation, and the Commission has begun to draft the EC common positions.

Box 6.4  The spaghetti bowls of European bilateralism: Part II

Almost simultaneously with the EAs, the Central European countries (CECs) have created their own sets of trade agreements: the Central European Free Trade Area (CEFTA) between Czechoslovakia, Hungary, and Poland in 1992, and the Baltic Free Trade Area (BFTA) between Estonia, Latvia, and Lithuania in 1994.

If the BFTA covers both industrial and farm goods, the CEFTA covers industrial goods (excluding foodstuff) and a limited set of farm and food products (but Bulgaria, Romania, and Slovenia, which acceded to the CEFTA later, have been able to benefit from large exceptions in agriculture). Provisions on technical regulations and service liberalization are very limited. This partial coverage reflects two key features of the intra-CEC agreements. They are conceived as complementary to the EAs and accession to the EC, and they have a strong bilateral touch. This touch flows from the CECs’ aversion to supranational institutions, generated by a deep-seated hostility to the trade regime that existed under Soviet hegemony, and by a fear that such institutions could endanger their accession to the EC.

The CEFTA and BFTA could have led to a CEFTA-BFTA-EC free trade area, but they failed to do so. Intra-CEFTA tariff reductions were rapidly followed by protectionist countereactions for a wide range of products (alcoholic beverages, tobacco products, fuels, cars etc.) in the form of import surcharges, technical regulations, and the absence of cumulation of rules of origin within the CEFTA or BFTA (Enders and Wonnacott 1996). Safeguard measures have been implemented more often and strictly on imports from CEC partners than on imports of similar products from the EC.

More recently, several CEC governments have been more vocal about the loss of their fiscal revenues—resulting from intra-CEC trade liberalization—than about the similar (and much larger) consequences of the EAs. This “deflection” of EC-CEC conflicts to intra-CEFTA or intra-BFTA disputes reflects the strength of the political forces backing market opening with the hub, and the weakness of the political forces supporting market opening with the other spoke countries.

In many respects, these difficulties reveal the weakness of the justification for PTAs on the basis of “proximity” and “natural partners.” After all, Estonia is as distant from Bulgaria as from France, and the historical links between Poland and France may be closer than those between Poland and Hungary.
Box 6.5 The enlargement process: Missing a historic opportunity?

Each EA preamble specifies that the “objective of the [name of the CEC in question] is to become a member-state of the EC.” The CECs were unhappy with this formulation: they wanted a sentence presenting the accession as the common objective of the CEC in question and of the EC.

The EC insisted on keeping such a unilateral formulation because it wanted to make clear its refusal to negotiate any component of the acquis communautaire and to use the enlargement process as an opportunity for reforming the EC’s badly designed policies. As a result, the existing and future member-states are locked in the existing intra-EC deals (as was first illustrated by the nonnegotiability of CAP when Britain joined the EC), leaving the WTO as the only external source of reforms.

Viewed from the CECs’ perspective, it is crucial to realize how much of a moving target the EC is for a candidate country. The Single Market, which was supposed to be firmly established by 1993 (most EAs were already signed by then), has since been relying on more directives every year. The legal framework required by the European Monetary Union (EMU), the Common Foreign and Security Policy (CFSP), and the Justice and Home Affairs (JHA) is continuously expanding. The Copenhagen Council (1993) imposed a few, but politically sensitive for certain CECs, additional requirements such as the protection of minorities. The Madrid Council (1995) added the “adjustment of administrative structures,” a condition that few current EC member-states would fulfill. The Berlin Council (1999) made clear that the existing Common Agricultural Policy will not be expanded to the CECs (see main text). Also, the new Accession Partnerships between the EC and CECs have linked the granting of EC preaccession funds to hard conditionalities on CECs. For instance, Poland was asked to restructure its steel industry (a reasonable goal per se but the Partnership Agreement is silent on the key issue of the interactions between EC and Polish steel restructuring, see appendix A, case 11) and to free short-term capital movements (a debatable goal in the short and medium run).

The EC’s day-to-day approach to enlargement is compounding all these difficulties. It consists of a bureaucratic and persnickety process: it is aimed at monitoring CECs’ fulfillment of the entire EC acquis communautaire before entering the EC and it tries to minimize the number and the time span of exceptions as much as possible.

Such an insistence on a strict preaccession conformity approach contrasts strikingly with EC’s own history when member-states adopted slowly the EC regulations that were difficult for them to introduce, as best revealed by the many infringements on the translation of EC directives into national laws (see chapters 4 and 5) and by “opting-out” options (including under the disguised form of slow privatization). The EC insistence will have long-term costs: it forces CECs to hastily pass hundreds of laws to comply with EC requirements, and hence it risks creating “virtual” legal frameworks (i.e., texts not, or loosely, enforced) in Central Europe, all the more because implementing certain aspects of the acquis, such as environment directives (see main text), imposes huge costs on CEC economies.

The enlargement process follows a strict procedure. First, the Commission “screens” the situation of each CEC to identify the difficult issues likely to arise in the negotiations. Then, bilateral discussions involving EC member-states, the Commission, and each CEC are “opened” to discussion on a chapter-by-chapter basis (the whole acquis communautaire has been split into 30 “chapters,” see rows in table 6.3) by the successive EC Presidencies. This was done first for the Luxembourg Group.
Box 6.5 (continued)

of CECs, and then for the Helsinki Group (for a more detailed presentation, see Mayhew 2000a).

On each opened chapter, candidate countries first present their “position” (requests for arrangements). The Commission then presents its own assessment of the situation. Finally EC member-states present their “common position.” Once all the contentious points in a chapter to be kept on the table of negotiations are determined, the chapter is “closed.” As of April 2001, only about half the chapters have been closed, with the Helsinki Group increasingly catching up with the Luxembourg Group. Once all chapters are closed, real negotiations will begin. As a result, the real negotiation stage has not yet been reached by any CEC—in fact, the common position of the EC member-states is still far from being known for most of the chapters.

Table 6.3 presents two possible definitions of the acquis communautaire: the Treaty provisions that are the core of the acquis and are undoubtedly nonnegotiable (they make up the EC Constitution), and the “secondary legislation” consisting of roughly 1,500 directives (a nonnegligible number of which could have been subject to review and reform if the EC had been ready to use the enlargement process as an opportunity to improve its own policies).

The breakdown between closed and still open chapters reveals a striking asymmetry: conflicts of interest are concentrated in chapters with a high dose of secondary legislation, whereas the constitutional Treaty provisions do not raise major problems (except the visa issue in Justice and Home Affairs, which is particularly sensitive because, ultimately, it will define “new” borders, cutting traditional links in Central Europe, for instance between Poland, Belarus, and Ukraine, or Hungary and Romania).

This asymmetry of problems suggests that the enlargement process is more about narrow economic interests than about long-term perspectives. This impression is magnified by the EC’s unilateral decisions to grant to itself long transitional exceptions from certain core Treaty provisions, as best illustrated by the freedom of movement of workers. Under German and Austrian pressures, the Commission has proposed a five-year transition period (with a possible extension for a further two years) during which the current EC member-states will be able to keep their restrictions on workers from CECs (exceptions on such crucial Treaty provisions and for such long transition periods are unlikely to be granted to CECs). Moreover, it remains to be seen if this contrast between EC’s lax position on its own obligations and its strict position on CEC obligations will not be amplified when member-states (finally) come to the forefront of the negotiations (as of April 2001, this was not yet the case).

Such an enlargement process reveals a lack of vision on the part of the EC—and maybe also the fact that the EC may feel overwhelmed by an enlargement involving 170 million people (if one includes Turkey) with wide differences of income per capita and culture.

It also shows that the EC has not learnt an essential lesson from its own experience: the EC does not trust markets to discipline CEC behavior despite the fact that during the last 40 years, they have disciplined France, Germany, Italy, and a few other member-states reluctant to open goods or services to competition. As a result, the EC is unable to adopt a strategic approach of enlargement—that is, to focus on the few core components of the acquis communautaire to be included in the preaccession exercise (for instance, a robust banking sector), leaving the other aspects to market forces and to postaccession compliance by the CECs.

This lack of vision and focus could add huge political costs to the economic opportunity costs of an enlargement process expressly not used as an opportunity to deliver domestic reforms. The EC may then have lost a historic opportunity.
These negotiations have been made more complicated, and probably slower, by the December 1999 Helsinki European Council decision to extend them to the remaining CECs (the so-called second wave, or “Helsinki Group”, which consists of the rest of the CECs and Malta), partly as a recognition of their support during the Kosovo war. Last, if the 2000 Nice Inter-Governmental Conference (IGC) between the 15 EC member-states has dealt with institutional issues, such as voting weights and the Commission size in the EC with 25 member-states (all matters for which the Nice Treaty is not really necessary and which could be handled with the Accession Treaties), it has not dealt with the substantive economic problems of accession.

The accession negotiations are likely to be most difficult on three topics, all key in the context of trade and commercial policies: agriculture, regional subsidies, and technical regulations. In addition, they are expected to also be difficult on foreign policy and Russia, two noneconomic issues with clear echoes in trade policy, and on justice and home affairs (which are also related to trade policy, to the extent that they touch CEC capacities for legal enforcement and upholding the rule of law).7

Of course, agriculture is the most difficult chapter of negotiations. It is still a large sector (in value added and employment) in CEC economies, including the CECs that have no substantial comparative advantages in this sector (only Bulgaria, Poland, and Romania are considered potentially large producers of farm products in the future). During the 1990s, political pressures on CEC governments increased, with substantial declines in farm production in most CECs (8 percent in cereals, 28 percent in milk), and with the emergence of trade deficits accompanied by increasing market shares for farm imports from Argentina, Australia, and Brazil.

In this difficult context, the 1999 EC Berlin Council made two inconsistent decisions. When dealing with EC farmers, it chose to reject the option of renationalizing farm aid on the (right) basis that the CAP is not a social policy (see chapter 4). But this approach would have logically required scheduling a progressive extension of the whole CAP, including farm income support, to the CECs. Far from going in this direction, the Berlin Council included a financial agreement that made it clear that EC direct income subsidies would not be extended to CEC farmers by earmarking a maximum amount of €3.4 billion in 2006 for CEC accessions, whereas available estimates of the budgetary costs of extending the pre-Berlin CAP to the CECs fell within the range of €5–15 billion for the Czech Republic, Hungary, Poland, and Slovakia, and within the range of €9–23 billion for all the CECs.

The Commission tried to rescue the Berlin Council decisions, but it made things worse. It justified the Council’s position with the fact that EC farm-
Table 6.3 The EC enlargement to Central Europe, April 2001

<table>
<thead>
<tr>
<th>The &quot;chapters&quot;</th>
<th>Major Treaty provisions (new numbering)</th>
<th>Secondary legislation*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Free movement of goods</td>
<td>TEC 23–31, 94–97</td>
<td>503</td>
</tr>
<tr>
<td>2 Free movement of persons</td>
<td>TEC 39–42, 61–69</td>
<td>5</td>
</tr>
<tr>
<td>3 Free movement to provide services</td>
<td>TEC 39,43–48,49–55, 94–97</td>
<td>131</td>
</tr>
<tr>
<td>4 Free movement of capital</td>
<td>TEC 56–60</td>
<td>48</td>
</tr>
<tr>
<td>5 Company law and TRIPS</td>
<td>TEC 133, 295c</td>
<td>12</td>
</tr>
<tr>
<td>6 Competition policy</td>
<td>TEC 81–89</td>
<td>19</td>
</tr>
<tr>
<td>7 Agriculture</td>
<td>TEC 32–38</td>
<td>383</td>
</tr>
<tr>
<td>8 Fisheries</td>
<td>TEC 32</td>
<td>4</td>
</tr>
<tr>
<td>9 Transport policy</td>
<td>TEC 70–80</td>
<td>49</td>
</tr>
<tr>
<td>10 Taxation</td>
<td>TEC 90–93</td>
<td>46</td>
</tr>
<tr>
<td>11 European Monetary Union</td>
<td>TEU, TEC 98–124</td>
<td></td>
</tr>
<tr>
<td>12 Statistics</td>
<td>TEC 117</td>
<td></td>
</tr>
<tr>
<td>13 Social policy</td>
<td>TEC 42, 87, 125–130, 136–148</td>
<td>52</td>
</tr>
<tr>
<td>14 Energy</td>
<td>TEC 154</td>
<td>21</td>
</tr>
<tr>
<td>15 Industrial policy</td>
<td>TEC 157</td>
<td></td>
</tr>
<tr>
<td>16 Small- and medium-sized enterprises</td>
<td>TEC 137, 157, 163</td>
<td></td>
</tr>
<tr>
<td>17 Science and research</td>
<td>TEC 35, 157, 163–173</td>
<td>6</td>
</tr>
<tr>
<td>18 Education</td>
<td>TEC 149–150</td>
<td>63</td>
</tr>
<tr>
<td>19 Telecom and information technology</td>
<td>TEC 154–156</td>
<td>12</td>
</tr>
<tr>
<td>20 Audiovisual and culture</td>
<td>TEC 87, 151</td>
<td>1</td>
</tr>
<tr>
<td>21 Regional and structural policy</td>
<td>TEC 76, 101–104, 154, 158–162</td>
<td></td>
</tr>
<tr>
<td>22 Environment</td>
<td>TEC 157, 161, 174–176</td>
<td>144</td>
</tr>
<tr>
<td>23 Consumers and health</td>
<td>TEC 33, 34, 81, 82, 87, 95, 152–153</td>
<td>12</td>
</tr>
<tr>
<td>24 Justice and Home Affairs</td>
<td>TEU, TEC 61–69</td>
<td></td>
</tr>
<tr>
<td>25 Customs union</td>
<td>TEC 131–135</td>
<td>4</td>
</tr>
<tr>
<td>26 External relations</td>
<td>TEU</td>
<td></td>
</tr>
<tr>
<td>27 Foreign and security policy</td>
<td>TEU</td>
<td></td>
</tr>
<tr>
<td>28 Financial control</td>
<td>TEU</td>
<td></td>
</tr>
<tr>
<td>29 Financial and budgetary provisions</td>
<td>TEU, TEC 189–312</td>
<td></td>
</tr>
<tr>
<td>30 Institutions</td>
<td>TEU, TEC 189–312</td>
<td></td>
</tr>
</tbody>
</table>

Provisionally closed chapters

Opened chapters 1,509

Memorandum items: Current European Community

| Date of signature of association | — |
| Population (million) | 377.6 |
| GDP (euro) per capita (at PPP) | 21,200 |

* Negotiations for accession of Turkey have not started yet.
TEC = Treaty establishing the European Community.
TEU = Treaty on European Union.
TRIPS = Agreement on Trade-Related Aspects of Intellectual Property Rights.
a. Number of directives in the acquis communautaire (in 1997).
b. OECD Codes (see chapter 5).
c. Multilateral ad hoc Treaties for TRIPS (see chapter 5).

ers will suffer income losses due to scheduled price decreases, whereas CEC farmers will not. This justification has two flaws. It ignores the fact that “intervention” prices of agricultural products in certain CECs (Poland and Slovenia) are becoming as high as EC prices, and sometimes even higher; and it would logically require that any “new” EC farmer (being the heir of a retiring EC farmer or an entrant into farming activities) would not be eligible for aid—and that unfortunately is not the case (see chapter 4).

In 2000, the EC tried to improve the situation by offering to the CECs a trade agreement eliminating export refunds and import tariffs on EC-CEC trade in farm goods (pork, poultry, cheese, fruit, and vegetables) that are not heavily dependent on the CAP in place. This marginal liberalization
has generated a lot of bitterness among the CECs, for two reasons. First, CEC tariff-free farm products will be subject to internal control for compliance with EC technical regulations in the country of origin; the extent to which such controls will be a substitute for EC border protection remains to be seen in the near future.

Second, this “freer” trade comes at the cost of constraints on production; production quotas will be imposed on CEC farm products included in these trade agreements, raising the question of the level at which these quotas will be fixed. CECs have requested quotas based on their produc-

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8. Again, the fact that tariff-free farm exports from the CECs to the EC would increase from 37 to 77 percent as a consequence of this agreement is less a measure of the scope of liberalization than of the severe restrictiveness of the CAP for the rest of CEC exports.
tion during the late 1980s, but the EC has argued that such levels of production reflect the distortions of nonmarket economies, and hence are not acceptable. This is not a minor issue: for instance, CEC pork production declined by 24 percent during the 1990s. The bitterness is particularly high in Poland, which is the major CEC producer of most of the products involved (e.g., it produces 40 to 50 percent of CEC pork output). In this context, the Polish WTO strategy during the Uruguay Round (adopting a high level of protection to minimize compensation when joining the EC) is becoming a trap; it has made its farm sector barely competitive, by EC standards, for the products covered by the agreement (e.g., the production price of pork is 5 percent higher in Poland than in France).

The second major issue raised by CEC accessions consists of the considerable increase in the population living in EC regions that could be qualified as “poor,” and hence eligible for regional aid. This problem is exacerbated by the fact that part of the farm problem could be handled through this approach. Direct income support to small farmers could be provided under this heading (assuming that the de-coupling principle will be fully respected and tightly monitored to avoid the past and current mistakes of the CAP—a big “if” in the EC context). Traditionally, the regional issue is dealt with by the so-called Structural and Cohesion Fund transfers. However, the Berlin Council decision to cap EC transfers from these funds at 4 percent of the recipient country GDP has had two effects. It reduces, probably severely, the CEC expectations in this domain. And it implies that a large portion (80 percent) of the structural aid currently given to EC regions should be reallocated to CEC regions.

Such a drastic shift is hardly compatible with the view prevailing among current EC member-states, according to which structural aid is an “acquired right.” Ireland successfully defended its rights at the Berlin Council, despite the fact that its per capita GDP was 107 percent of the EC average in 1999, and is expected to be 117 percent in 2001. At the Nice Intergovernmental Conference (2000), Spain kept its right to veto decisions on regional aid until 2013 at least. Last, the Financial Framework of the Berlin Council clearly suggests that the EC expects new member-states to pay their full contribution to the budget—raising the question of the balance, during the first years of accession, between full contribution and still incomplete transfers (Mayhew 2000b).

Last but not least, the CEC accessions raise acute problems in the increasingly important domain of technical regulations and work safety regulations (see chapters 4 and 5, respectively). The estimated costs for the CECs to comply with the EC acquis communautaire in these matters are huge. For Poland, they have been estimated at 3 percent of current GDP for the directives on standards and safety rules in transport; 4.5 percent for the directives on the environment; and 0.5 percent for the directives on work safety in general, that is, a total of 8 percent, excluding the costs of
aligning the other directives related to the Single Market Program (Mayhew and Orlowski 1998). A World Bank study has also estimated that introducing the 320 EC environment directives alone would annually cost Poland $6–$13 billion (4 to 8 percent of its current GDP) for the next 20 years, and roughly half these GDP percentages for the Czech Republic (Mayhew 2000b). If correct, at least part of these sums (the part reflecting “excessive” environmental protection) is likely to represent a huge amount of forgone consumption in the cost-benefit analysis of EAs.

Assuming no sudden, deep changes in the EC approach, this brief survey suggests that the Berlin Council has tilted the rules in favor of the EC’s most powerful vested interests (farmers, poor regions) and against the candidate CECs—and that these changes reduce the benefits of full accession expected by the CECs. Moreover, by imposing costly investments to meet EC technical and environmental regulations, the alignment to the EC acquis communautaire will impose forgone consumption on the CECs, another source of reduced benefits for the CECs from accession—and hence of increased acrimony in the CECs.

**CECs’ Influence on EC Multilateral Commercial Policy during the Coming WTO Round**

Because the accession process will be based on a gradual approach (as it was for Greece, Portugal, and Spain, which benefited from transitional periods), the coming WTO round likely will see all the CECs outside the EC—with some of them bitter vis-à-vis the EC. This situation raises the following question. What can the CECs’ influence be on EC multilateral trade and commercial policy during the coming round? (The question of what the CECs can do to accelerate their accession to the EC is left for the concluding section of the chapter).

If few (if any) CECs will become EC members during the negotiations of the coming WTO round (assuming that these negotiations will be concluded by 2005–09), and most of them will become full EC member-states after 2010, what then could CEC influence be on EC multilateral trade policy during the coming WTO round? This question deserves particular attention when the preaccession CECs’ level of protection is lower than the EC level (when higher, the CECs will be better off to adopt existing EC protection). Such a situation is not rare because, if the CECs have an economy-wide average tariff close to the EC average, they have individual (by product) tariffs often different from EC ones. The answer differs significantly for industrial products, farm goods, and services.

In manufacturing, the CECs can adopt two attitudes. They may be “neutral” if they do not feel concerned (for instance, if there are no CEC consumers) and hence leave the EC to grant “compensations” (in accor-
dance with GATT rules) to its trading partners for getting the right to
align acceding CEC tariffs to EC tariffs (i.e., the right to impose the *acquis communautaire* on the CECs). Alternatively, the CECs may exert pressure
on the EC to align its higher MFN tariffs to the corresponding lower pre-accession CEC MFN tariffs. The choice between these two attitudes will
depend on the intra-CEC balance of interests between producers and consumers for every product. CEC consumers will always be interested in
lower postaccession EC tariffs, whereas CEC producers will not necessarily oppose EC tariff decreases to the extent that they are accustomed to
lower protection at home, so that they can expect to increase their share of the EC market. The risk that CECs may have a negative influence on EC
trade policy is higher for products under nontariff barriers (in particular CEC producers may oppose EC tariff reductions following the elimination
of MFA quantitative restrictions on textiles and clothing) and for products for which coalitions of protectionist lobbies can mobilize several
CECs (this situation may happen in one-fifth of the CEC industrial sectors; UN-ECE 1996).

In agriculture, the CECs grant a smaller overall support to agriculture than the EC. In 1998, the estimated CSE-based tariffs (based on the old
method; see chapter 2) range from 10 percent (Hungary) to 28 percent
(Poland), relative to 49 percent for the EC. (Based on PSEs, the gap is even
larger, with the EC support being three times higher than Poland’s and nine times higher than Hungary’s.) This broad view suggests that the
CEC accessions will raise the critical issue of the ability of the enlarged EC
to meet its WTO commitments, defined as the sum of the EC-15 and CEC
commitments. The levels of difficulties ahead differ according to the type
of trade barrier—as outlined in the following four points.

First, in terms of tariff commitments, most CEC accessions will be likely
to require compensation because CEC tariffs (except for those of Poland
and Romania) are lower than EC tariffs: by 20 percent for Hungary, by
50 percent for the Czech Republic and Slovakia, by almost 100 percent
for Estonia.

Second, concerning import quotas, adding EC and CEC commitments
would increase EC quotas by 15 percent for milk, by 50 percent for cereals and beef, and by 150 percent for chicken. However, EC vested farm
interests hope to use the “netting out” technique, which consists of adding
the EC and CEC quotas and subtracting the bilateral portion of these quo-
tas (this technique tends to reduce the quota increases following accession; it has been used for the last EC enlargement, although it is still pend-
ing approval in the WTO).

Third, in terms of export subsidies, the situation will be very difficult
for the enlarged EC. Almost all the CECs have scheduled low levels of export subsidies, and export capacities estimated for 2006 could amount to
twice these levels (of course, aligning CEC internal prices to EC prices
would worsen the situation by increasing the CECs’ need for export sub-

224 MEASURING THE COSTS OF PROTECTION IN EUROPE
sides). Moreover, the EC-15 has no room to maneuver because it is already at the limit of its own export subsidy commitments (see chapter 4).9

Fourth, concerning domestic support, the EC-15 has enough reserves in unused support under the current definition of the AMS to be able to fulfill the commitments of the enlarged EC. But the final situation will depend on how successful the EC will be in keeping unchanged the existing definition of domestic support; see chapter 4).

Solving export subsidy problems and minimizing tariff compensation would require that the EC substantially reduce its protection on farm products (as was noted above for manufacturing). Further reforms of the Common Agricultural Policy during the coming decade should make lower EC prices more consistent with CEC commitments. The Berlin Summit has left very limited scope for decisive moves in this direction (see chapter 4).

Meanwhile, the competitive pressure from CEC farmers on EC farmers may be reduced for two reasons. Barriers on trade of key farm products between the CECs and the EC are still high, and CEC farmers are often inefficient, making them unable to exert the competitive pressure that wide-ranging regional agreements could potentially provide (Josling 1998). They need massive restructuring, but they fear that they will not have the time to do it, both because EC subsidized farm exports will quickly compete with their own products in the open CEC markets and because CECs’ cheap land may be quickly bought by rich EC farmers and resold at high prices later, after the CAP introduction in the CECs. Meanwhile, their hope for massive direct financial transfers from Western to Central Europe is fading, all the more because many CEC farms are small, hence unlikely to get much from the existing CAP biased in favor of large farms (see chapter 4). As a result, farmers in certain CECs (Poland) are both increasingly fiercely opposed to enlargement and trying to slow down any further reform of the CAP—amplifying the protectionist drift in CEC farm policies, which can be already observed (Hartell and Swinnen 1998).

In services, the situation is quite different, largely because that joint competence of the Community and member-states in commercial policy (see chapter 5) opens a Pandora’s box of potential coalitions—and hence of strategies from vested interests. For those services for which certain member-states have a strong protectionist stance, the CECs may align their position to the least open EC member-states so as to eliminate all risk of future claims for compensation. But in turn, that will make more difficult the emergence of a compromise about an EC “common position” among the current EC member-states—the protectionist member-states claiming to have external “supporters” of their policy.

9. In 1997, Hungary was granted a waiver from its export subsidy commitments on the basis of miscalculations owing to trade conducted in nonconvertible currencies, and set revised commitments (subject to specific annual reports).
In such cases, the WTO compensation mechanism has the perverse impact of inducing the CECs to “maximize” their current level of protection, and hence to reinforce the most protectionist interests in the EC in order to minimize compensation in the future. This scenario has been illustrated by Croatia, Estonia, and Latvia, which ultimately adopted the most protectionist version of the EC Television Without Borders Directive, at the cost of delayed accession to the WTO (the United States insisted that these CECs adopt the open-minded version of the directive) and of reinforced protectionism in certain EC member states.

Such a negative scenario could be amplified by the fact that foreign direct investment in CEC services has meant the almost complete elimination of CEC firms in many services (including those where CEC firms initially may have had some advantages, such as retail trade) and the dominance of EC firms possibly eager to expand to the CECs the protection they enjoy in the EC. The counterbalance flows from the fact that large EC service firms tend to have a worldwide perspective—that is, they may be ready to exchange protection in small CEC markets for better access in large markets elsewhere.

The Mediterranean and Balkan Countries

Many EC discriminatory trade agreements have been generated by traditional political alliances between particular EC member-states and non-EC countries, and the agreements with the Mediterranean and Balkan countries do share this feature (see box 6.6). However, the key motive behind EC trade policy in these two regions is the fear that “doing nothing” for and with these countries could be a source of pan-European troubles or even regional wars, as mentioned during the launch of the Euro-Mediterranean Partnership by the Barcelona Summit (1995). This motive explains the often limited content of these trade agreements. The EC has used them more as a way to guarantee a status quo and traditional trade flows (hence it tends to conceive them as minimal variants of EAs) than as the key component of a strategy to open the partners’ economies. It also explains the EC’s deep and long-lasting hesitations on the Turkish accession case. Of course, such an approach has generated some disillusionment among all these EC partners.

All these agreements are prone to generate static costs, which can be amplified by a temporary increase in the EC partner’s effective rates of protection, as is shown in the case of Tunisia (Hoekman and Djankov 1997b). Political benefits to be expected from trade agreements with the

10. Indeed, it might be the case that certain measures to be implemented by Turkey (restraints on textiles and clothing) will protect the EC more than the Turkish market (Hartler and Laird 1999).
### Box 6.6 The spaghetti bowls of European bilateralism: Part III

The EC agreements with Mediterranean and Balkan countries constituted a “bazaar” of all conceivable trade agreements with different economic concepts and legal structures (customs union, free trade agreement, etc.), different sectoral coverage (agriculture, manufacturing, services, etc.), different GATT-WTO status, and so on (Pelkmans and Brenton 1997).

The EC-Turkey Customs Union goes further than a typical EA in some respects. It requires Turkey to adopt the EC Common Tariff (including EC tariff preferences to third countries, i.e., Turkey must echo the EC discriminatory regime), and to approximate EC customs regulations (rules for imports, administering quotas, antidumping, and other trade remedies, including on textiles and clothing), and the EC policy of technical regulations. But it is a more limited agreement than an EA for the **three freedoms** and the **legal framework**, except for the approximation of competition laws and TRIPS.

It does not cover the farm sector (the principle of free movement of farm products is stated, but without a deadline), despite its enormous importance for the Turkish economy (Hartler and Laird 1999). The EC has similar customs union agreements with Andorra and San Marino (two ministate enclaves in the EC territory), Cyprus, and Malta.

The EC agreements with Mediterranean countries (enforced with Tunisia, 1998; Morocco and Israel, 2000; signed with Jordan and the Palestinian Authority, 1997, and with Egypt, 2001; and in negotiations with Lebanon, Algeria, and Syria) replicate the EAs, but in a “limited” form. The **free movement of goods** does not include faster elimination of EC textile quotas; the period of transition for the EC partners is longer (12 years, generally); concessions on agriculture are marginal; and provisions on the right of establishment in services and on competition policy (including state aid) have no specific language and no time frame.

Since mid-2000, the EC trade policy with the Balkan countries has undergone rapid and important changes. Until 2000, it was based on the 1980 Trade and Cooperation Agreement (TCA) with the former Yugoslavia, although the TCA has not been renewed for the Federal Republic of Yugoslavia between 1998 and 2000. TCA provisions have been prolonged by the “Autonomous Preferential Trade” (APT) agreements with Bosnia-Herzegovina and Croatia, extended to Albania in 1992, and expanded by a more generous agreement with Macedonia. All these agreements consisted of EC nonreciprocal tariff reductions on imports from the Balkan partner, with a complicated, extensive system of annual tariff quotas and import surveillance (Messelin and Maur 1999). In 1999, the EC shifted to Stabilization and Association Agreements, more generous but of reciprocal nature, starting with Macedonia.

In 2000, the EC unilaterally dismantled all its barriers on imports from the successor states of Yugoslavia (except for Slovenia, already under an EA), including those from Serbia and Montenegro after the free elections in these countries. The only exceptions to this unilateral liberalization are fish, baby beef, wine, and certain textile and clothing products (plus aluminum in the case of the Federal Republic of Yugoslavia), for which there are tariff quotas. The EC put one condition to its unilateral move, namely that the beneficiaries shall be “ready to engage [.] in regional cooperation [..] in particular though the establishment of free trade areas [..]” (Council Regulation (EC) No. 2007/2000, Article 2, Official Journal L240, 1–9, 23 September 2000).

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EC are few, if any: the military security component in the region is out of the reach of the EC and of its member-states, as is illustrated by the Gulf and Yugoslav wars; and the credibility and insurance components are even weaker than for EAs. Dynamic benefits seem limited by the reputa-
tion of these countries for red tape creativity and their small capacity for foreign direct investment (Brown, Deardorff, and Stern 1997; Page and Underwood 1997), despite the existence of capital-abundant countries in the Arabian Peninsula as a possible source of FDI flows in the case of the Mediterranean countries (Council on Foreign Relations 2001).

The EC PTAs with the Balkan countries have one interesting feature. The EC’s unilateral liberalization of September 2000 has been conditional on the fact that all these successor states of the former Yugoslavia shall be ready to sign PTAs between themselves. However, it remains to be seen whether the countries involved will grasp this condition for liberalizing their trade between themselves and vis-à-vis the rest of the world (as they should; see the concluding section).

EC Discriminatory Trade Policy in the 2000s: The End of the Road?

In the mid-1990s, the EC faced a situation that very few observers would have predicted six years earlier. The disastrous 1990 GATT Ministerial in Brussels, which should have closed the Uruguay Round, witnessed a Community hopelessly riveted to its Common Agricultural Policy. By contrast, the 1994 WTO Ministerial in Marrakesh showed the EC among the strong WTO supporters—an impression reinforced by the EC’s role during the negotiations on the 1997 financial services protocol. In the late 1980s, EC member-states were bickering over the need for regulatory reform of services. By contrast, the core legal framework of the Single Market Program was delivered almost on time in 1993, fueling the impression of an almost finalized Single Market in goods and services, soon to be completed by a unique currency. Also in the late 1980s, the EC was cosily adapted to a permanently divided Europe. And again in sharp contrast, the EC’s web of discriminatory trade agreements in place in 1995 was seen as a sign of its continental hegemony.

In this rather euphoric context of the mid-1990s, the EC took a series of trade initiatives with the United States, Mexico, Mercosur, certain Asian countries, and Russia—that is, far outside the traditional scope of its discriminatory trade policy. As of mid-2001, these initiatives have led to limited results, raising the following question: can such initiatives really fly, or are they doomed to be window-dressing operations, and even to fail, announcing the ebb of EC discriminatory policy?

Transatlantic Partnership with the United States

The EC’s efforts to develop a transatlantic partnership have relied on a wide range of political motives, emerging every time when circumstances
were favorable. First, the EC feared that the United States could be irreversibly less supportive of the WTO system, increasingly attracted by regional trade initiatives with Asian or Latin American dragons, and irreparably tired of the EC’s negative-minded, slow-growing, rent-riddled behavior in trade matters. The EC also feared that considerations attached to US military hegemony would spill over into domains, such as trade, that it felt were more subject to de facto EC-US “condominium”—through US unilateral trade or economic measures, such as the Helms-Burton or Iran-Libya sanctions acts, among many other unilateral sanctions (Bayard and Elliott 1994). Last, the EC hoped that, after 50 years of having been a follower in trade matters, it could again be a world leader—challenging US supremacy in the WTO and becoming “more” equal to the United States in these limited economic matters.

As the incumbent hegemon—but also because of a portfolio of trade and investment flows well balanced among the major world economic regions—the United States has responded to these EC initiatives with a wide range of nuances of coolness, from skepticism to cautious approval (Barfield 1998). The corresponding US-EC discussions have produced many texts: the Transatlantic Declaration (1990), the New Transatlantic Agenda (1995), the Transatlantic Partnership for Political Cooperation (1998), and the Transatlantic Economic Partnership Statement and Action Plan (1998). And they have created many forums: the Transatlantic Business (TABD), Legislator (TLD), Consumer (TACD), Environment (TAED), and Labor (TALD) dialogues. The question is: what have been the substantive results of all these efforts?

The New Transatlantic Agenda package launched in 1995 led to four results in 1998: (1) a mutual-recognition agreement (with a similar MRA signed with Canada) dealing exclusively with conformity assessment procedures on a relatively wide range of industrial products (telecom equipment, electronic and pharmaceutical products, medical devices, recreational marine craft, etc.), but difficult and slow to be implemented (see chapters 4 and 5); (2) a veterinary agreement on a wide range of meat and fish products, even more difficult and slow to be implemented (see chapter 4); (3) a customs cooperation and mutual-assistance agreement; and (4) the agreement on the “positive comity” approach in competition law enforcement (each country could request from the other to take into account its interests when exercising its competence on competition matters; see chapter 5).

These results are not minor, but they can hardly be qualified as outstanding. The most important achievement is the MRA on industrial products, estimated to allow cost savings of roughly €1 billion a year from the nonduplication of conformity assessment (the so-called rule “approved once, accepted everywhere”) on €50 billion annual bilateral imports. This result is largely due to the TABD (which is not a negotiating forum, but a source of recommendations from the chief executives of large US and EC firms presented to US and EC administrations). Moreover, the
TABD is intervening heavily every time the MRA implementation faces difficulties, as in late 2000.

These limited results, and the EC’s new confidence following the 1997 WTO agreements on financial services and telecoms, led the Commission to table, in March 1998, a New Transatlantic Marketplace Agreement (NTMA) with four key proposals: (1) elimination of all tariffs on an MFN-basis by 2010, conditional on a “critical mass” of other countries doing the same; (2) removal of technical barriers; (3) creation of a free trade area in certain services (financial services, maritime transport, legal and medical services, satellite-based telecoms, and energy services have been mentioned by the European side), which would be based on the “negative list” method of negotiation, on the liberalization of cross-border trade on a host country basis, on the right of establishment without exceptions and restrictions, on the liberalization of market access through provision of national treatment, and on the elimination of regulatory obstacles on the basis of mutual recognition; and (4) liberalization beyond existing WTO commitments in public procurement, investment, and TRIPS.

From an economic perspective, the NTMA project avoided the most blatant risks of static costs associated with discriminatory trade agreements in goods. Provision (1) represented a de facto “normalization” of the EC position; the EC was catching up with respect to a similar commitment made in 1996 by Japan and the United States within the APEC forum. It was equivalent to a unilateral liberalization of all the countries considered as pertaining to the “critical mass” (a concept close to the “principal-supplier” approach in WTO negotiations). By contrast, the assessment of the economic effects of provisions (2) to (4) is less clear. In particular, it is unclear whether the US-EC MRA agreements would have been automatically and unconditionally open to third parties, that is, would obey the fundamental WTO nondiscrimination principle (for a general discussion of the issues raised by the MRA approach, see chapter 4).

The NTMA project did not live two months. It met fierce opposition from the French government (scared that agriculture and audiovisuals, excluded from the NTMA, could be brought back at a later stage), heavy reluctance from half the other EC member-states (often because of concerns about the NTMA’s consistency with the WTO framework) and much skepticism from the United States and the rest of the EC member-states. The major divergence between the US and EC sides was the balance in the proposed NTMA between liberalization (market access) and “regulatory convergence” in services. The United States found too little of the first ingredient (not only because of the exclusion of agriculture and audiovisuals), and too much of the second, with “regulatory convergence” evoking too much the ideas of reregulation and harmonization, possibly coupled with common judicial review. In any case, the NTMA was thought to require the European Council’s unanimous approval—and it did not get it.
The London US-EC Summit of May 1998 tried to rescue the NTMA content by launching the Transatlantic Economic Partnership (TEP), and a joint action plan was adopted in November 1998. However, the TEP is much vaguer than the NTMA. Its multilateral component evokes strengthened US-EC cooperation for the preparation of the Seattle WTO Ministerial, whereas its bilateral component focuses on five domains (technical barriers, certain services, government procurement, TRIPS, and food safety and biotechnology). As of April 2001, there has been no concrete result from the TEP.

The 1999 US-EC Bonn Summit was mostly the mere occasion to examine issues of common relevance for the United States and the EC: cooperation on Balkan and Russian crises, exchange of views on telecoms or e-commerce, and so on. In fact, the summit focused more on political matters than on trade-related issues. Meanwhile, the TABD began to face difficulties. On the one hand, it produced new recommendations on technical regulations (e.g., on third-generation wireless standards and on health issues, such as AIDS, tuberculosis, or malaria); it has been increasingly active in emerging US-EC disputes (e.g., on the EC TRs reducing the noise of landing “hush kits” for aircraft, the EC’s “metric only” labeling directive, or the use of the precautionary principle in the case of GMOs) by creating an early warning system; and it has taken initiatives in certain domains (biotechnology products, personnel mobility, corruption, international accounting standards, and specific e-commerce issues, e.g., protection of personal data, electronic authentication). On the other hand, a substantial number of TABD requests or proposals have been rejected by the administrations, leaving many pending problems in highly regulated industries, such as chemicals—e.g., the registration of a new crop protection active ingredient requires 2 tons of paperwork, with different sets of registration forms in every EC member-state (Engel 2000).

The TEP’s limited results can be explained by the generally unfavorable circumstances that followed the withdrawal of the NTMA project. In December 1998, the OECD-based negotiations on the Multilateral Agreement on Investment collapsed. The US and EC business communities, increasingly frustrated by the legal complexities and turf wars generated by the negotiations, withdrew their support from the project, leaving the OECD Secretariat to fight alone a hopeless media battle with a few non-governmental organizations determined to kill the initiative (Henderson 1999). More important, perhaps, the TEP initiative was so close to the coming WTO round that the TEP lost most of its raison d’être.

Beyond all these circumstances, there may be more profound reasons for the very limited results of all the transatlantic initiatives. The first flows from the magnitude of the economic gains expected from such initiatives, which are negligible if the initiative is limited to the elimination of tariffs on industrial goods, and which remain modest (real income increases by 0.3 percent in the United States and by 0.8 percent in the EC) if
the liberalization includes agriculture, elimination of antidumping remedies, a broadened public procurement agreement, and a reduction in trading costs related to technical regulations (Baldwin, François, and Portes 1997).11

Political reasons also play an important role. From the US side, the support for transatlantic initiatives has been at most moderate, because convinced American supporters of such initiatives were divided in two groups so different that they could hardly constitute a broad and effective coalition (Frost 1997). On the one hand are the “Atlanticists,” who tend to believe in gains from multilateral free trade and hence are unmoved by the potential economic gains to be expected from preferential agreements but are moved by political considerations, in particular, the fear of increasing political distrust between the United States and the EC. On the other hand are a protectionist-minded but heterogeneous set of “Japanbashers,” trade unionists, and environmental nongovernmental organizations, all interested in creating a big transatlantic trade bloc against new competitors from Asia and elsewhere.

From the EC side, the NTMA and TEP failures have revealed a more realistic portrait of the EC than the euphoric self-portrait of the mid-1990s (see the beginning of this section). The EC has not been able to deliver these initiatives, because its ability to meet all its Uruguay Round commitments in farm trade after 2000 looked increasingly debatable (chapter 4); because the EC solution to the problems raised by technical regulations is less successful than generally stated (chapter 4); because service liberalization in the Single Market emerged as a much more difficult and long-term undertaking than initially thought, with a crucial debate about more regulation or more liberalization (chapter 5); and because EC support for the WTO is blurred by almost a hundred bilateral discriminatory agreements in Europe (see above). Some of these issues were excluded from the negotiations with the United States (e.g., agriculture), but they have nevertheless been used as excuses by reluctant EC member-states.

All these remaining EC (and US) unsettled problems raise the same key issue. Most of the transatlantic liberalization would require almost the same adjustment efforts from the EC as a WTO deal (because in many instances US firms are among the most efficient world producers), although the United States could not offer to the EC the same concessions as those available in such a WTO deal (because US markets are smaller than world markets). In other words, it may be more profitable for the EC to negotiate a WTO agreement than the corresponding transatlantic agreement.

11. As a matter of comparison, expanding the widest liberalization scenario to all the OECD countries would result in an estimated 2.4 percent increase in the US GDP and a 3.3 percent increase in the EC GDP.
Spillovers in Eastern Europe, Latin America, and Asia Pacific

Like the United States, the EC is bound to be a “diminishing giant.” Its weight in world trade and output is doomed to decline, if and when developing economies grow. From an economic standpoint, this inescapable fate should not generate fears; welfare is far from depending on size (Wolf 1994). And from a political perspective, relatively small countries have proved to be enormously influential—from the Dutch Republic of the 17th century to the role of Australia or Sweden in the GATT or WTO forums (Hellstrom 1999).

Eastern Europe

During the first half of the 1990s, in contrast with the United States, western Europeans were untouched by the diminishing giant syndrome because of the eastward expansion of the EC. But the EC’s web of Central European agreements reached its maximum size in the mid-1990s. The EC concluded Partnership and Cooperation Agreements (PCAs) with Russia in 1994 (entered into force in 1997), Azerbaijan, Kazakhstan, Kyrgyzstan, Moldova, and Ukraine. Because most of these EC partners are not WTO members, these PCAs aim essentially to introduce WTO key disciplines into bilateral trade (MFN and national treatment, no quantitative restriction) and include agreements on textiles and clothing, and iron and steel.

Since 1997, the EC has toyed with the idea of a free trade agreement with Russia, and more recently, with the idea of a “wider vision” including Russia, Ukraine, and of the Caucasus countries (Emerson and Gros 1999). But the political realities of the region have frozen all these efforts, probably for a long period, and 1999 witnessed increased protection on both sides, particularly in steel, a product of primary interest for Russia. As a result, the EC seems to have reached its extreme borders at a time when the United States is looking to expand its new discriminatory agreements in the Americas and in Asia, as is best illustrated with the Free Trade Area of the Americas (FTAA) and the US-Singapore Free Trade Agreement. The US moves, combined with the absence of clear perspectives in Russia, have induced the EC to try to be more involved in Latin America and Asia.

Latin America

The EC’s most visible efforts concern Latin America. They have been facilitated by the desire of Mexico and Mercosur members to balance their regional (NAFTA, Mercosur, and the future FTAA) and extra-regional interests.

In January 2000, the Commission approved the results of the negotiations on an Economic Partnership, Political Coordination, and Coopera-
tion Agreement with Mexico. The trade component of the agreement aims to eliminate tariffs for most goods by 2003, but farm products sensitive for EC farmers are excluded (only 62 percent of the current bilateral farm trade will be covered by the agreement, which denies Mexican access to EC markets for all the key products under the EC Common Agricultural Policy, from cereals to sugar, with a review scheduled for 2003), and there are complex provisions for certain sectors (cars and car parts, garments) that required long negotiations about the exact regime of preferential rules of origin to be enforced.12

In services and public procurement, EC firms will benefit, according to the Commission, from the same treatment as US and Canadian firms, with the exception of audiovisuals, maritime cabotage, and air transport. The agreement also covers TRIPS, set at the “highest international standards,” according to the Commission, cooperation in competition law enforcement, an effective dispute settlement mechanism (without prejudice to the parties’ WTO rights), and a foreseen start (in 2003) of liberalization in investment (in recent years, the EC has been comparatively more important as a source of investment in Mexico than as a trading partner, a situation probably related to the impact of NAFTA).

As a result of this agreement, Mexico will be, with Israel and Jordan, one of the few countries to have free trade agreements with the United States and the EC—opening the possibility that the new discriminatory agreement between Mexico and the EC will erode some of the distortions generated in the Mexican economy by the previous one. It is unlikely that Mexico could become a full “hub” with respect to the United States and the EC (many biases in favor of the hub being eroded by the size of the two spokes). But such a set of Mexico-centered PTAs should induce Mexico to “multilateralize” its concessions to its three most important trading partners (Canada, the United States, and the EC)—a process that should naturally lead to WTO-based negotiations.

Prospects for an EC-Mercosur (and Chile) agreement are difficult to assess. Negotiations were formally launched in June 1999, but substantive talks on tariff issues (more topics should be covered) will not begin before July 2001. Moreover, the negotiating mandate specifies that negotiations are not expected to be concluded until after the end of the next WTO round. The nature of the agreement is still vague (it may not be a fully fledged free trade area). No outcome is expected before 2005, and no substantial trade liberalization before 2010–15 (IRELA 1999).

12. The EC estimates that the agreement is WTO-consistent because, by January 2003, it will cover almost 100 percent of the existing bilateral trade in industrial and fish products, and 62 percent of the existing bilateral farm trade, hence more than the threshold of 90 percent of total bilateral trade considered by the Commission as the threshold for WTO-consistency. However, current trade flows reflect existing barriers—implying that the 90 percent threshold is unlikely to be reached under fully liberalized trade.
Asia Pacific

The EC asked for membership in APEC, then for observer status, but the two requests have been turned down. Finally, the EC established an institutional dialog with the Asian side of APEC through the Asia-Europe Summit Meetings (ASEM). However, the three meetings held in Bangkok (1996), London (1998), and Seoul (2000) have not led to any substantial result in trade and economic relations—the Seoul Summit even witnessing embarrassing official divergences between the EC member-states on whether, how, or when the North Korean regime should be recognized.

EC policy toward China’s accession to the WTO has been largely a freerider on US policy. In the late 1990s, the EC left the United States to play the difficult role of reminding the Chinese authorities that the WTO is essentially about rules (meanwhile, China was benefiting from its EC GSP status, although it was often subject to the modulation and graduation components of this status; see above). In 1999–2000, when Chinese concessions began to be solidified in written bilateral agreements, the EC tried to expand the concessions obtained by the United States to additional goods and services of interest to it.

The resulting key points of the EC-China pre-accession bilateral agreement are: (1) Chinese tariffs will be reduced from 25 to 65 percent to 5 to 10 percent for 150 products (from spirits through cosmetics, leather, footwear, and textiles to machinery, appliances, and building materials); (2) tariff quotas on several farm products (rape oil, pasta, butter, wheat gluten, wine, and fruit) will be increased; (3) Chinese import monopolies on oil and (NPK) fertilizers and its export monopoly on silk will be eliminated; (4) Chinese opening in services will be improved, in particular in telecoms, insurance (with seven licenses guaranteed to EC firms), and distribution; and (5) investment (joint venture) operations will be eased in motor vehicles. Of course, most of the concessions granted in bilateral agreements (with the United States or the EC) will be extended to all WTO members under the GATT most-favored-nation principle.

The coming years will be critical for understanding the exact nature and content of the Chinese accession. In particular, it will be essential to see how often the status of a “nonmarket economy” (NME) in antidumping procedures will be applied against Chinese firms accused of dumping, and how often the “transitional product-specific safeguard” (TPS) provision included in the United States-China bilateral agreement will be invoked (these provisions will last 12–15 years). In both cases, the already relatively important size of many Chinese exporters implies that a frequent use of these instruments may have important direct effects (on the country implementing the measures) and indirect effects (on the other trading partners of China).

As is shown in appendix B, NME status leaves no chance for allegedly dumping firms to defend themselves, and it allows imposition of anti-
dumping measures twice as large as usual ones. Moreover, the TPS allows China to impose countermeasures on imports from a country having imposed safeguard measures on Chinese imports under certain conditions, and as a result, contributes to turning the WTO regime from an instrument for opening markets into an engine generating a sequence of safeguards restricting trade (the United States or the EC imposes a TPS measure, then China imposes countermeasures, to which the United States, the EC, or any other country may react). Because of these two provisions, one can legitimately fear that the Chinese accession could replicate Japanese accession to the GATT: when Japan acceded to the GATT, existing GATT members imposed on Japan many “gray measures” and voluntary export restraints, which have lasted almost 30 years and endangered the whole GATT system.

A last interesting question to raise is the EC’s reaction to the emergence of regional trade agreements in Asia Pacific (starting with the expected negotiations for such an agreement between Japan and South Korea). As of mid-2001, it is too early to see whether these Asian PTAs could launch a new wave of regionalism (Bergsten 2000), or whether things will not change much.

So far, only PTAs involving small and relatively open Asian countries have been signed (e.g., Singapore-United States or Korea-Chile). The economic impact of such PTAs is probably minute. Of course, PTAs involving Japan will change the scale of the effects, but the Japan-Korea PTA has not yet officially reached the negotiation stage (as of early 2001). Moreover, estimates suggest that PTAs involving Japan and Korea will be a source of gains only if China is included (Scollay and Gilbert 2001). In other words, economic gains would require political boldness in Asia. In such a fluid environment, it is hard to forecast EC reactions to Asian PTAs, all the more because estimates of the impact of Asian PTAs on the EC (and the US) economy are small.

A Final Remark

In sum, so far, all the EC trade initiatives toward Eastern European, Latin American, and Asia-Pacific countries (except one, with Mexico) have not led to substantial outcomes. This result could be explained by specific circumstances (the Asian or Brazilian crisis, the Russian transition process), by differences in trade doctrine (APEC vs. EC approaches to economic and political integration), or by opposition on key topics (e.g., trade and labor issues).

But there may be a more profound—permanent—reason for the failure of all these initiatives. All the conceivable PTAs of some substantial economic magnitude include EC partners that are and will increasingly be among the world’s strongest competitors of EC producers. As a result,
opening the EC markets to these exporters has the same economic consequences for EC producers as opening them to all WTO members (assuming that these PTAs will not be mere window dressing). For instance, a substantial free trade agreement with Mercosur will be almost as demanding in competitive pressures and adjustments for the EC farm sector (cereals, meat, sugar) and certain industrial sectors (from food industries to leather products, cars, or even aircraft) as a WTO agreement with the same product coverage.

The same will be true for PTAs with large Asian economies and the EC manufacturing sector, and for a PTA with the US and the EC manufacturing and service sectors. Conversely, all these PTAs have the disadvantage of offering (much) more limited trade-offs than a WTO deal of the same magnitude. The Mercosur economies, for example, cannot provide the same markets for EC exports as a world including the United States and Asia Pacific, and vice versa for the other possible PTAs. Of course, the balance of gains and costs of all these new discriminatory agreements does not have the same magnitude for all the EC because of the magnitude of the EC partners. For instance, a PTA with Russia would be closer to the Europe Agreements examined above than a PTA with APEC or Japan. It remains that the cost-benefit balance of new discriminatory agreements is likely to be less favorable than the balance offered by the corresponding WTO agreements.

Political benefits from all these initiatives are also hard to see for the EC (they constituted the main gain for the EC of the discriminatory agreements examined in the first and second sections above). Asian and Latin American countries have made clear that a trade agreement with the EC should not be perceived by the EC as an act of defiance against the United States—and even less as an act of allegiance to the EC. Political gains to be expected are thus small for the EC, all the more because they can be counterweighted by political frictions with the United States (which would not exist in the context of WTO negotiations).

In fact, one may argue that all these PTAs require the existence of an EC foreign policy. Because it is impossible to negotiate PTAs simultaneously with Eastern European, Latin American, and Asian countries, there is a need to make priorities, that is, to develop a fully fledged foreign policy. In the absence of such a policy, PTAs will be merely “time-buying” devices, and hence a source of large frustrations, as is best illustrated by the EC policy with respect to Turkey. As of mid-2001, the EC does not seem to

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13. Indeed, Russia is likely to lose from such an agreement, for reasons similar to those suggested for the CECs (Brenton, Tourdyeva, and Whalley 1997; Enders and Wonnacott 1996). An economically sound agreement between the EC and Russia should also include most of the Soviet Union successor states (except for the Baltics, which are already linked to the EC). But such an agreement may be more difficult to sign because a wide definition of Eastern Europe makes the existence of strong competitors of EC firms more likely.
Regionalism versus Multilateralism: The Dispute Settlement Dimension

The debate about regionalism versus multilateralism is often limited to considerations about trade agreements per se. It ignores the key role of the “remedies,” that is, the institutional guarantees that an agreement will be observed. (This point has been indirectly touched upon above, with the “insurance” motive for discriminatory trade agreements.) PTAs signed by the EC are loaded with a tight net of safeguard clauses of many types, certain of them with debatable GATT consistency, and all the disputes occurring within these PTAs are dealt with by bilateral “joint committees.”

The key alternative to bilateral remedies is the WTO-based Dispute Settlement Understanding (DSU), with its panels and appellate procedures considerably reinforced since the Uruguay Agreement. During the GATT period, the widespread skepticism about the operational inability of the settlement procedure to deliver enforceable panel recommendations has been shown unjustified to a substantial extent, except when the EC and the US have been involved (Hudec 1993). Even in this case, there have been successes. For instance, the two successive GATT panels (1989, 1991) on the EC oilseed regime led to substantial changes of EC policy in this sector.

However, if the new procedural rules under the Uruguay Round DSU ensure well-functioning settlement procedures, they have brought to the forefront concerns about the nature of the remedies, in particular the ultimate option of retaliatory countermeasures—the negotiating value of such measures (for small countries, relative to large partners) and the economic benefits for the domestic economy (of both small and large parties to the cases) being highly questionable (Mavroidis 2000).

The existence of alternative (bilateral vs. multilateral) dispute settlement tracks raises several questions about the possible strategic use of these alternative instruments by the EC. In particular, has the EC actively used the WTO dispute settlement procedure? Has it used it in a substitutive or complementary way to bilateral procedures incorporated in EC PTAs? Has this use been targeted at certain trading partners (and, vice versa, has the EC been targeted by certain of its trading partners)? A final set of questions is to examine whether, and how, the WTO dispute settlement mechanism contributes to shaping the dynamics of EC commercial policy.

The EC is an important user of the dispute settlement procedures. Table 6.4 shows that, of the 194 cases initiated between January 1995 and May 2000, the EC was involved in 92 (as a complainant or defendant, leaving aside 28 cases where the EC was a “third party.”) Interpreting these ab-
Table 6.4 WTO dispute settlement cases, January 1995–May 2000

<table>
<thead>
<tr>
<th>Status</th>
<th>Number of cases involving European Community</th>
<th>Number of cases involving United States</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>All cases</td>
<td>United States</td>
</tr>
<tr>
<td>Complainant</td>
<td>51 (39)</td>
<td>16 (10)</td>
</tr>
<tr>
<td>Defendant</td>
<td>41 (36)</td>
<td>22 (9)</td>
</tr>
<tr>
<td>Subtotal</td>
<td>92 (75)</td>
<td>41 (19)</td>
</tr>
</tbody>
</table>

EC = European Community. WTO = World Trade Organization.

Note: Figures in parentheses correspond to the number of cases, if they had mirrored trade flows. For the lists of “preferential” partners, see text.

Source: Dirk de Bievre (2000), Database on WTO DS cases, Florence: European University Institute; author’s computations.

Solute numbers in a meaningful way requires a comparison with trade flows to get a better sense of a possible overrepresentation of the EC. If perceived as reflecting the fact that the EC is one of the largest markets in the world (Hoekman and Mavroidis 2000), such an overrepresentation seems best measured by the number of cases in which the EC is a defendant, namely 41 cases, whereas the trade-based reference figure would suggest only 36 cases. These five “extra cases” may thus be seen as mirroring the healthy role of the WTO. It is the forum in which small trading countries can best defend their interests against large partners (table 6.4 shows one extra case for the United States).

However, the EC’s overrepresentation is much higher when it is a complainant, namely 51 cases instead of the trade-based reference number of 39. The relatively excessive overrepresentation in cases where the EC is a complainant with respect to cases where it is a defendant may be a measure of a quite different phenomenon: an intrinsic EC “hyperactivity” in the dispute settlement procedures mirroring the EC’s dominance of the WTO forum (such hyperactivity can be also observed for the United States). This conclusion fits the fact that several dispute settlement cases lodged by the EC have resulted from the EC Trade Barriers Regulation, by which the EC defends what it considers its rights (see appendix B).

A good understanding of EC hyperactivity would require a comparison with EC use of the bilateral dispute settlement procedures. Unfortunately, there is no information available on such use—this lack of information being certainly a bad practice, and possibly a bad omen. However, table 6.4 shows one extra case for the United States.

14. What follows relies on the assumption that the structure of merchandise trade flows reflects the structure of merchandise, services, and intellectual property rights. This assumption may underestimate the weight of industrial countries, which may trade more services and property rights than developing countries. Complaining cases are compared with export flows, and defending cases with import flows.
6.4 shows that there is no WTO dispute settlement case lodged by the EC against its PTA partners (EEA countries, Switzerland, Norway, ACP countries, CECs, and Balkan and Mediterranean countries), whereas the trade-based reference number of dispute settlement cases for all these countries would have been a dozen. In other words, the EC seems to use the regional and multilateral tracks in a strictly complementary way.

This conclusion is supported by two additional observations. First, none of the almost hundred countries that have bilateral trade agreements with the EC has used the WTO dispute settlement procedures against the EC, whereas they have used these procedures against each other, as is illustrated by the cases opposing the Czech Republic, Hungary, and Slovakia. Second, this last feature is not observed for the United States, which has several cases with its two NAFTA partners, although the trade-based reference number of cases with Canada and Mexico is much larger than the observed number. The strict complementary use of bilateral and WTO dispute settlement procedures by the EC reveals the long-lasting repercussions of the EC’s discriminatory trade agreements through their remedies.

The impression of a strategic use of the WTO dispute settlement procedures by the EC and the United States is reinforced when one examines United States-EC relations. As is shown by table 6.4, the EC has complained against the United States 1.6 times more often that what trade flows would have suggested, relative to 1.3 times when all the EC trading partners are included. The United States shows an even more intense targeting of the EC. One could argue that these figures reflect nothing new, but rather the existing stock of long-lasting, recurrent disputes between the EC and the United States on bananas, beef hormone, the Foreign Sales Corporations regime, countervailing duties in the steel industry, and so on (Miller and Wasserman 1992).

Because panel recommendations under the Uruguay Round DSU are much more binding than the mere “moral” victory associated with GATT panels, this targeted use of dispute settlement procedures by the EC (and the United States) may reflect two incentives at work: an effort to get support from independent panels on (often) old-time trade quarrels; and a tactic to balance “lost” cases by “won” cases for public relations purposes. If the first incentive is acceptable, the second is the source of a worrisome drift for the whole WTO system, and another sign of the “privatization” of EC trade policy (i.e., its capture by private interests, an observation that can be extended to the United States).

Table 6.4 focuses on countries—a preliminary approach that makes sense to the extent that it insists on the decision of a government to lodge a case and on the public relations aspects. But as always in international trade, disputes between countries mirror conflicts within industries. Table 6.5, which is based on the industries and topics involved in dispute settlement procedures, confirms, to a large extent, the main observations presented in chapters 2 and 3. First, part A of table 6.5 reveals a concen-
The above analysis is limited to the initiation of cases. Ideally, it would be important to look at the pattern of outcomes of cases. Unfortunately, there is not enough information on this aspect; if a minority of cases do lead to WTO panel decisions, most are terminated by bilateral consultations, on which there is little or no available information (for some de-

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**Table 6.5 EC-related dispute settlement cases, by topic and sector**

<table>
<thead>
<tr>
<th>Topic or Sector</th>
<th>United States as defendant</th>
<th>Others as defendants</th>
<th>United States as complainant</th>
<th>Others as complainant</th>
<th>All cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cases ranked by topic, as percent of total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Import measures</td>
<td>25.0</td>
<td>42.9</td>
<td>27.3</td>
<td>73.7</td>
<td>42.4</td>
</tr>
<tr>
<td>Contingent protection</td>
<td>18.8</td>
<td>14.3</td>
<td>10.5</td>
<td>10.9</td>
<td></td>
</tr>
<tr>
<td>TRIPS</td>
<td>6.3</td>
<td>5.7</td>
<td>36.4</td>
<td>5.3</td>
<td>13.0</td>
</tr>
<tr>
<td>Export measures</td>
<td>8.6</td>
<td>4.5</td>
<td>4.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic taxes</td>
<td>12.5</td>
<td>11.4</td>
<td></td>
<td></td>
<td>6.5</td>
</tr>
<tr>
<td>Subsidies</td>
<td>6.3</td>
<td>8.6</td>
<td>22.7</td>
<td></td>
<td>5.4</td>
</tr>
<tr>
<td>Government procurement</td>
<td>6.3</td>
<td></td>
<td></td>
<td></td>
<td>4.3</td>
</tr>
<tr>
<td>Other topics</td>
<td>31.3</td>
<td>8.6</td>
<td>9.1</td>
<td>10.5</td>
<td>13.0</td>
</tr>
<tr>
<td>Cases ranked by sector, as percent of total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Farm products</td>
<td>18.8</td>
<td>11.4</td>
<td>18.2</td>
<td>57.9</td>
<td>23.9</td>
</tr>
<tr>
<td>Textiles, clothing, footwear</td>
<td>12.5</td>
<td>14.3</td>
<td></td>
<td></td>
<td>9.8</td>
</tr>
<tr>
<td>Food products</td>
<td>8.6</td>
<td>4.5</td>
<td></td>
<td></td>
<td>6.5</td>
</tr>
<tr>
<td>Chemicals</td>
<td>6.3</td>
<td>8.6</td>
<td>9.1</td>
<td>5.3</td>
<td>7.6</td>
</tr>
<tr>
<td>Steel</td>
<td>12.5</td>
<td>5.7</td>
<td></td>
<td></td>
<td>4.3</td>
</tr>
<tr>
<td>Electronics</td>
<td>6.3</td>
<td>5.7</td>
<td>13.6</td>
<td></td>
<td>6.5</td>
</tr>
<tr>
<td>Cars</td>
<td>11.4</td>
<td></td>
<td></td>
<td></td>
<td>4.3</td>
</tr>
<tr>
<td>Beverages</td>
<td>11.4</td>
<td></td>
<td></td>
<td></td>
<td>4.3</td>
</tr>
<tr>
<td>Cement</td>
<td>12.5</td>
<td>5.3</td>
<td></td>
<td></td>
<td>1.1</td>
</tr>
<tr>
<td>Other products</td>
<td>37.5</td>
<td>17.1</td>
<td>31.8</td>
<td>5.3</td>
<td>21.7</td>
</tr>
<tr>
<td>Services</td>
<td>6.3</td>
<td>5.7</td>
<td>22.7</td>
<td>5.3</td>
<td>9.8</td>
</tr>
<tr>
<td>Total number of cases</td>
<td>16</td>
<td>35</td>
<td>22</td>
<td>19</td>
<td>92</td>
</tr>
</tbody>
</table>

EC = European Community.
TRIPS = Agreement on Trade-Related Aspects of Intellectual Property Rights.

*Source:* See table 6.4.
talled analysis of two key dispute settlement cases in which the EC has been involved, see the beef hormone cases in chapter 4 and the banana cases in appendix A, case 19).

A last, key question is: What is the impact of WTO DSU cases on the dynamics of EC trade policy? Looking at the EC implementation of WTO panel rulings leads to a disturbing observation: the EC has been the first WTO member—and so far, the only one—to refuse to comply with WTO panel rulings and to prefer to face countermeasures by complainants—a reaction accompanied by loud criticism in Europe against the Appellate Body rulings, which has fueled suspicions against the WTO (for a balanced analysis of these rulings, see Vermulst, Mavroidis, and Waer 1999).

From a purely legal viewpoint, the EC attitude is consistent with a strict interpretation of WTO reciprocity. But from a WTO systemic perspective, the fact that one of the two largest trading partners prefers to face countermeasures weakens the whole trade regime. Such countermeasures are paid in the form of additional tariffs, or other trade-restrictive measures, imposed by the complaining parties on their EC imports. In other words, not only are existing EC barriers left intact but new barriers are raised in the rest of the world—hardly a benefit for consumers in the EC or in the complaining countries.

One could argue that the EC choice of facing countermeasures simply mirrors the rigidity of EC decisional procedures in trade policy, which were underlined in chapter 1. In other words, the dispute settlement mechanism would be too fast for the current capacity of the EC decision-making process to deliver a decision changing one aspect of its trade policy, despite the fact that, on average, almost three years separate the initiation of a dispute settlement case from the final outcome. This argument is hardly acceptable for the EC’s trading partners (especially if they judge the EC reactions against the celerity that the EC requires for US compliance with the Foreign Sales Corporations panel). Why should the rest of the world pay for the incapacity of the EC to make rapid decisions? (The banana and hormone cases in which the EC has accepted to face countermeasures, have lasted for a decade.)

Concluding Remarks

The main conclusion of the chapter is that the EC’s addiction to discrimination may be on a slow ebb for two reasons: (1) The EC has realized that many of the PTAs that it has signed in the past have been a costly bargain for its partners and an exercise in futility for its own economic interests—hence, a political burden in the long run that more than compensates for the immediate political gains. (2) The EC may realize that all the discriminatory agreements of some size that it could conceivably sign in the future offer a cost-benefit balance less positive than the one available in fu-
ture WTO rounds, simply because they impose on EC firms the same competition pressures and adjustment efforts as equivalent WTO liberalizations (most of these new PTAs would include efficient world producers) without increasing foreign market access for EC products and services to the same extent as WTO deals. Moreover, the coming two decades are likely to witness the disappearance of many (one hundred!) existing EC discriminatory agreements through the enlargement process, improving the functioning of the WTO system, if (a big “if”) the EC-25 are as pro-free trade as the current EC-15. All these evolutions are consistent with (1) the discretion with which the EC texts released for Seattle have mentioned the regional approach (the texts are de facto limited to a defense of the existing discriminatory agreements with developing countries, in particular the ACP states), and (2) the interest shown by these texts in the unilateral elimination of all tariffs imposed by the industrial and emerging-market economies on imports from the least developed countries.15

What concrete initiatives could the EC undertake to accelerate this desirable evolution? What follows suggests a few ideal actions aimed at amplifying the expected shift of the EC away from its old addiction to discrimination.

**ACP States and Developing Countries**

The scheduled renunciation of the old-fashioned ACP Conventions is a step in the right direction—above all for the ACP states. But the currently fashionable proposal of REPAs is not the best alternative, because it imposes geographical limits on ACP liberalization and deprives the ACP states of tariff revenues, which constitute their main source of public revenues. Of course, the EC could easily compensate for such losses by adequate transfers. But this is not a good solution; it weakens the ACP states even more by depriving them of the sovereign right to collect taxes, and it assumes that EC taxpayers will accept paying more in order to aid developing countries (an unwarranted assumption in the long run, with the risk of reducing EC public and private efforts in favor of additional development programs, e.g., education; see chapter 5). Moreover, the experience of the past 40 years about the use of EC aid in ACP states is so disastrous that it is hard to imagine that things could be improved on such a basis.

In an apparently paradoxical way, the EC could substantially improve the ACPs’ situation by adding a dose of “limited reciprocity” (instead of...

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15. In December 2000, the EC watered down its initial proposal for its own unilateral liberalization with respect to the least developed countries by introducing a tariff-quota regime (imports from least developed countries would be tariff-free only up to a certain amount) on the major LDC exports (sugar, rice, and rum) until 2006–08.
strict reciprocity as it plans to do) to its new agreements with them. More
precisely, the EC should make its new trade agreements with the ACP
countries conditional upon a commitment by these countries to decrease
and bind their MFN tariffs on a nondiscriminatory and as uniform as possible
basis (in other words, the EC would request reciprocity from the ACP
states limited to a moderate and uniform ACP tariff, instead of a 0 percent
tariff, as in the current REPA project).

Such an initiative would greatly benefit the ACP states. They could
keep their tariff revenues—it has been estimated for several sub-Saharan
countries that substituting a uniform tariff of roughly 15 to 18 percent for
the current system of tariff peaks and exemptions would provide the
same revenues (Messerlin and Maur 1999). Such an initiative would elim-
ine the distortions generated in the ACP economies by the existing com-
plicated tariff schedules, which range from 0 to 50 percent or more. Last
but not least, it would reduce a major source of state-related corruption in
the ACP economies (ACP customs will not be under constant pressure to
change import classifications to give exemptions or lower tariff rates, etc.)
and a source of tax evasion (being uniform, and levied on the widest possible
basis, the uniform tariff can be moderate, hence reducing incentives
for smuggling). The gains for the EC will be slightly better market access,
a much reduced need for granting the direct aid that is so difficult to man-
age wisely, no need to push for regional trade agreements between the
ACP states, and, above all, ACP partners much better equipped to un-
dergo faster growth.

Indeed, the EC could strengthen its WTO role, and get political benefits,
by launching a joint initiative from all the industrial and dynamic
economies to provide the ACP states (or the least developed countries)
with a worldwide regime based on the notion of “limited reciprocity.”

In March 2001, the EC launched the “Everything but arms” initiative,
which comprises EC unilateral suspension of tariffs on all imports from 48
least developed countries (LDCs). Three products (sugar, rice, and ba-
nanas) have a special time frame: tariffs (estimated at 83, 100, and 160 per-
cent, respectively, by the Commission [2000c]) will be completely sus-
pended only in 2006 (bananas) and 2009 (sugar and rice). During the
transition period, a tariff quota at zero duty on these goods will be opened
by the EC and increased by 15 percent on an annual basis. There are mech-
anisms allowing suspension of preferences, especially in cases of serious
disturbance to the Community markets and their regulatory mechanisms.
Such an initiative is estimated to increase LDC exports to the EC by 37
percent ($185 million)—assuming that market access will not be restricted
by more cumbersome rules of origin, antidumping, or safeguard mea-
sures (Hoekman, Ng, and Olarreaga 2001). Most of the expected export
gains are concentrated in sugar, and to a lesser extent in rice and cereals,
meaning that LDCs will get the full benefits of the initiative only at the
end of the long transition period.
The above suggestion of an EC leadership for a global initiative of developed countries would have several advantages for the LDCs compared to the “Everything but arms” initiative, which has the merit of existing. In particular, it would offer wider market access to LDC exports because it would include almost all the OECD countries, and maybe a few more. This is important because the LDCs do not have the same intensity of business relationships and good reputation in the various OECD markets, and hence do not have the same ability to grasp the opportunity of freer market access. Moreover, the proposal of “limited reciprocity” has the merit to introduce the kind of liberalization in the LDCs that is necessary for improving both the efficiency of their economies and the quality of their governance, and that enables the LDCs to grasp the opportunity of freer market access. One could argue that the difficulties with which the Commission has obtained the mandate “Everything but arms” despite the fact that it was limited to LDCs (which are tiny trading partners of the EC) suggest that a more ambitious proposal would not have survived the powerful EC protectionist interests in sugar, rice, and bananas. However, by initiating liberalization in the LDCs, the proposal based on “limited reciprocity” would have generated a wider coalition of export interests in Europe, hence a stronger counterweight to the narrow coalition of the EC protectionist farm interests.

Central Europe

The major initiatives that the EC could undertake in favor of Central European countries would consist of purely EC domestic actions (described in chapters 4 and 5): a profound reform of the CAP, an increasingly strict cap on antidumping and safeguard measures (e.g., by banning such measures for goods subjected to a tariff smaller than a jointly agreed threshold), and a substantial change in the EC approach to technical regulations and services (based on more conditional mutual recognition and on a stronger, market-driven orientation).

All these measures are necessary to accelerate the CECs’ accession to the EC. As already mentioned, they would also need to be complemented by a profound change in the EC approach to the enlargement process: focusing on the preaccession adoption by the CECs of only a few core directives of the acquis communautaire, ensuring their effective implementation in the CECs, while leaving the rest of the acquis for post accession adoption, trusting market forces and the integration dynamics to discipline CECs’ behavior, as they have disciplined the behavior of current EC member-states in the past and continue to do so.

CEC accessions will automatically provide a substantial cure for EC discrimination because they will eliminate the hundred agreements currently in force between the EC, CECs, and EFTA countries. But they raise
a key question: to what extent will the new EC member-states shift the currently relatively free-trade-oriented EC-15 to a more protectionist stance? The question is not superfluous: many CECs have revealed inward-looking attitudes during the last decade. It has often been claimed (Lawrence 1997; Sapir 1992; Cadot, de Melo, and Olarreaga 1999) that so far, the EC has induced its most protectionist members to open their borders more than they would have probably done without the EC. Whether this remark will have any chance to remain true when the EC has 25 member-states is an open question. Under present conditions, joining the EC will imply for most CECs an increase in their farm protection and a decrease in their protection of manufacturing and services (for estimates, see François and Rombout 2001). This new structure of protection could induce the CECs to increase their farm production and decrease their industrial and service productions, all evolutions that the CECs may want to resist by using EC instruments of protection (e.g., antidumping in goods and regulations in services) in order to rebalance EC protection in their “favor”.

Actually, it is more important in the shorter run to underline that the CECs have alternatives to EC actions at their disposal for accelerating their accession to the EC and decreasing the current costs of EAs. The CECs could align their MFN tariffs higher than the corresponding EC MFN tariffs to the level of these EC MFN tariffs without waiting for the end of the accession negotiations (Messerlin 1996c). By granting tariff concessions that are probably considered almost worthless by their WTO partners (because the CECs will decrease these tariffs to the EC level anyway as a result of their accession to the EC), the CECs will decrease static and transaction costs associated with EAs and improve their own environment for investors. The CECs may also get political gains from their initiative to the extent that it will generate pressure on the EC to shorten the transition period under the accession protocols (because their initiative will make the CECs instantly ready to enforce the EC Common Tariff).

The CECs could magnify the benefits of such an initiative by making this initiative a joint decision to be implemented in a common time framework. Given the CEC hostility to common institutions, it is important to note that such an initiative does not carry any institutional requirement. Only a joint declaration is needed, with each CEC specifying its own time frame to reach the common goal within the time frame decided in com-

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16. Possible CEC abuse of EC protection raises the question of the robustness of the existing EC decision-making process in trade matters. In particular, how would the complex 133 Committee (see box 1.2) work with more than 20 member-states having very different objectives in trade matters?

17. As a result, rules of origin for all the goods with the same tariff in the EC and CECs could be eliminated. Of course, those CEC MFN tariffs that are lower than EC MFN tariffs should not be increased—for WTO legal reasons, but more profoundly, for economic reasons (trying to lower the EC tariffs).
The additional gains it would bring would be a reduction of the static costs generated in the CEFTA-EFTA context, and possibly increased joint bargaining power vis-à-vis the EC.

**Mediterranean and Balkan States**

The existing trade agreements may be limited in economic terms, but they portray the EC as a continental hegemon—a dangerous illusion to the extent that the EC does not have military power, as has been illustrated in Kuwait, Bosnia-Herzegovina, and Kosovo.

A minimal goal for the EC would be to “rationalize” its nexus of agreements in the region. The Helsinki Council (1999) made one step in this direction with the quite unexpected acceptance of Turkey as a candidate country. But this step was largely an inescapable consequence of a long overdue EC promise in 1964, and it should not be overrated. There is still no date for opening negotiations with Turkey, and there is apparently no definitive EC consensus on its accession, as is shown by the fact that the Nice TEC version has not given Turkey seats in the European Parliament and weighting votes in the EC Council. If this uncertainty will last too long, the EC will be wise to give back to Turkey some degree of freedom, for instance by allowing the current customs union to become a free trade area (hence allowing Turkey to take trade initiatives).

In many respects, Mediterranean countries raise the same problems as the ACP states, although in a less dramatic way. The multiplication of Euro-Med agreements has led to massive preference margins granted by each Mediterranean country to the EC, whereas trade barriers between the Mediterranean countries, and between them and the rest of the world, have remained high, except to a large extent for Israel and Jordan because they have a PTA with both the United States and the EC. The ideal EC policy with respect to these countries could be similar to the policy sketched above for the ACP states; in particular, it could again be driven by the “limited reciprocity” approach.

Trade policy in the Balkans raises specific issues. Trade between the Balkan countries may still rely on ethnic relations (between Croatia and the Croat-Muslim Entity of Bosnia-Herzegovina, between the Federal Republic of Yugoslavia and the Serb entity of Bosnia-Herzegovina, between Albania and Kosovo) to such an extent that it is hard to know which borders (inter-state or inter-ethnic zone) really count. In such a politically volatile context, nondiscrimination has particularly strong merits. The EC initiative to open its markets to Balkan countries, conditional on the creation of PTAs between these countries, could be an interesting application of the above-mentioned policy of limited reciprocity—if the EC-sponsored regional PTAs strongly induce the Balkan countries to lower their MFN tariffs. Balkan countries not yet members of the WTO could
bind their tariffs at the level of EC MFN tariffs, but they should apply even lower tariffs as often as possible. This policy makes sense both because the accession of the Balkan countries to the EC is far away (not liberalizing as much as possible for such a long period of transition will be very costly for the Balkan countries) and because it eliminates potential problems with the EC (related to the compensation to be paid by the EC when the Balkan countries become EC member-states).

The EC: Ultimately Born to Support the WTO?

Outside Europe, all the PTAs of sizable economic magnitude that the EC could envisage signing include efficient trading partners: Japan, the United States, or groups of Asian or Latin American countries. Hence, they are likely to impose the same adjustment costs on the EC as WTO deals without granting the same benefits as such deals in market access. PTAs of smaller size, such as the Mexico-EC Treaty, may reduce some distortions generated by preexisting agreements (NAFTA, in the Mexican case). But the conflicting provisions and obligations between these PTAs where the hub is a small economy (Mexico) and where the spokes are large economies (the United States and the EC) may induce their signatories to look for a WTO deal to substitute for these PTAs, that is, for a “multilateralization” process of these agreements. In sum, in all these configurations, the EC ends up with robust (because based on its own interests) reasons for becoming a robust WTO supporter.

Being a strong WTO supporter cannot be limited to shifting negotiations from a bilateral context to the multilateral WTO forum. It also requires becoming a careful supporter of the WTO dispute settlement mechanism. The EC has expressed difficulty in using the WTO panel rulings as a support for eliminating domestic protectionist measures favoring blatantly narrow vested interests capable of getting support from foreign vested interests (as is best illustrated by the banana case; see appendix A, case 19).

This weak capacity to keep under control its own vested interests should induce the EC to promote the following key improvement of the WTO dispute settlement procedure, in order to benefit from stronger support from the WTO. Today, a WTO member faces countermeasures if it decides not to follow panel recommendations. This option transforms the WTO from a liberalizing force into an engine of protection because the defendant’s protectionist measures condemned by the WTO panels are followed by the complainant’s protectionist countermeasures authorized by the WTO. Instead of such countermeasures, WTO members should get additional concessions from the WTO partners refusing to enforce panel rulings, under the renegotiation provisions of GATT Article XXVIII and GATS Article XXI; this option would keep the proliberization momentum of the WTO texts.