PROTECTIONISM OF THE EUROPEAN UNION: ITS NATURE AND CONSEQUENCE

Dissertation submitted to Jawaharlal Nehru University
in partial fulfilment of the requirements
for the award of the Degree of

MASTER OF PHILOSOPHY

Submitted by

M. RAJESH

CENTRE OF AMERICAN & WEST EUROPEAN STUDIES
SCHOOL OF INTERNATIONAL STUDIES
JAWAHARLAL NEHRU UNIVERSITY
NEW DELHI - 110 067
INDIA

2000

CENTRE FOR AMERICAN & WEST EUROPEAN STUDIES
SCHOOL OF INTERNATIONAL STUDIES
JAWAHARLAL NEHRU UNIVERSITY
NEW DELHI-110067

14 July 2000

CERTIFICATE

CERTIFIED that the Dissertation entitled *Protectionism of the European Union: Its Nature and Consequence* submitted by *Mr. M. Rajesh*, an M.Phil. student of the Centre for American & West European Studies, School of International Studies, of this University, in partial fulfilment of the requirements for the award of the Degree of *Master of Philosophy* is a original piece of research work.

To the best of my knowledge and belief this has not been submitted to this or any other University in the past for grant of any degree.

We therefore recommend that this Dissertation be placed before the Examiners for consideration for the award of the Degree of Master of Philosophy.

PROFESSOR B. VIVEKANANDAN
Supervisor & Chairperson

GRAM : JAYENU. Tel. : 6107676, 6167557- Extn. 2334. TELEX : 031-73167 JNU IN FAX : 091-11-6198234

"Take Alarm of the Terrible,
Till it hasn't drawn near;
The Terrible Coming into View,
Strike it without Fear"

- Pearls of Wisdom from Kautilya (Chanakya)

ACKNOWLEDGEMENTS

The journey through the murky world of protectionism has been both fascinating as well as tedious. The persons who helped me to undertake this journey are too numerous to name personally. But a few of them deserve special mention. I am indebted to my supervisor Professor B. Vivekanandan, without whose earnest, sincere and efficient guidance, the work would have been impossible to complete.

I am grateful to the staff of JNU, CII and FICCI libraries, who have helped me find relevant material for the study.

The work has also been made possible with the assistance of Mr. Menon, Mrs. Joyce, and Mr. Yadav who helped me to find relevant material for my topic.

I am indebted to the friendship, advice and cooperation of a large number friends. Special mention should be made of Mr. S. Mahesh, who not only helped me in the quest for relevant study material but also was a great source of emotional support. I am also extremely thankful to Miss R. Simi, who, in spite of her tight schedule, took pains to help me prepare an exhaustive list of books for my bibliography.

The main source of inspiration and support for my work have been my parents. Their love and affection has prevented me from going astray from my preoccupation. Without them, this work would have been anything but complete.

This work is in fact a tribute to the memory of my late grandparents, Sri N. Bhaskaran Nair, Sri N. Gopinathan Nair and Smt. Rajamma, whose blessings have always been with me. No doubt, their love, affection and blessings will help me to attain greater heights. I express my gratitude to Smt. Sudakshinamma, my

grandmother, with whom I have shared some of the best moments of my life till date. I also wish to thank my brother, M. Rahul, whose suggestions have helped me to improve my work.

Last, but not the least, I thank God for steadfastly supporting me and helping me complete my work.

M. Raj

Jawaharlal Nehru University
18 July 2000

M. RAJESH

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PREFACE

A few proposition on which most economists seem to be in agreement concerns the undesirability of trade restrictions which are applied by the European Union (EU) and other industrial countries to import from the rest of the world. Restrictions impose economic costs on the European Union itself and they limit the opportunities of other countries especially those from the Third World to prosper through greater participation in world trade. None of the standard economic arguments which can be applied in mitigation of protection, apply in practice. The excuses are merely political.

European trade protectionism is an area on which many scholars have done path-breaking work. A few of their observations would be worth noting as a background to the present study. *Hughes and Waelbroeck*, in 1981 suggested that there was prima facie evidence of growing protectionist resistance. The authors have shown a distinct slowing down of the rate of market penetration for imports entering industrial countries.[1]

Brodin and Blades, in their import penetration project for the World Bank show that developing countries are finding market penetration in some of the EU countries, a difficult task. The following Table is illustrative of this.[2] It should be

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1 The results of their study have been referred to in: Vincent Cable, "The Impact of EEC Trade Policy on Developing Countries", in H. Giersch, *Free Trade in the World Economy* (Tubingen: Institut fur Weltwirtschaft an der Universitat Kiel, 1987), p.304.

2 The tables given below depict a selected reference period to drive home the point.

noted that the volume of LDC trade being lower, a higher percentage of market penetration than the exports of other industrialised countries alone should not be considered as an index of openness of markets. In fact, a growth in penetration rate of less than 8-10% per annum is hardly significant for Less Developed Countries.

A SAMPLE OF THE LEVELS OF ANNUAL GROWTH OF MARKET PENETRATION

	Level of Import Penetration		Growth of Penetration	
	1975	1983	1970-1980	1975-1983
All Industrial Countries				
LDC Imports	2.2	3.3	6.8	5.3
All Imports	15.0	17.5	4.3	1.9
USA				
LDC Imports	2.1	3.6	8.6	6.9
All Imports	7.0	10.3	4.6	4.9
Japan				
LDC Imports	1.8	2.0	5.8	1.3
All Imports	4.9	5.3	2.4	0.8
Germany				
LDC Imports	2.6	4.3	8.2	6.6
All Imports	24.3	35.1	5.2	4.7
France				
LDC Imports	1.5	2.9	7.8	8.4
All Imports	17.9	26.2	3.7	4.8
Italy				
LDC Imports	2.2	5.0	9.4	10.6
All Imports	21.9	31.2	6.9	4.5
U.K.				
LDC Imports	3.0	3.4	-0.3	1.9
All Imports	22.0	44.9	6.0	3.7
Netherlands				
LDC Imports	4.2	6.7	6.9	6.1
All Imports	55.4	67.1	2.1	2.4
Belgium				
LDC Imports	3.8	6.9	7.8	7.9
All Imports	64.6	100.3	3.8	5.7
Sweden				
LDC Imports	2.1	3.4	3.9	6.2
All Imports	35.1	44.9	2.5	3.1

Source: Vincent Cable, "The Impact of EEC Trade Policies on Developing Countries"

The relative difficulty to penetrate EU markets in comparison WITH other OECD markets for non-oil Less Developed Countries can be seen from the following table.

OECD IMPORT OF MANUFACTURES FROM NON-OIL LDCs[3]

	USA	JAPAN	EEC
1973	17.2	25.3	14.5
1974	18.7	22.9	14.4
1975	18.4	21.6	14.9
1976	21.0	25.8	16.4
1977	21.4	24.5	16.9
1978	22.8	26.3	16.5
1979	23.8	28.4	18.0
1980	25.0	25.5	18.5
1981	25.5	27.3	18.2
1982	26.7	26.7	18.3
1983	29.1	24.5	18.2

Source: Vincent Cable, "The Impact of EEC Trade Policies on Developing Countries.

Further *Keith Penketh* in his essay "External Trade Policy"[4] has indicated the possibility of the danger that increased penetration of markets from inside the EC may induce some member states to attempt to compensate by reducing the freedom

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3 Ibid., p.302.

4 Keith Penketh, "External Trade Policy", in Frank McDonald and Stephen Dearden, eds., *European Economic Integration* (London: Longman, 1992), p.157.

of access of third countries. Such protective practices are less transparent and less open *vis-a-vis* the world outside than within the EC.

J. Michel Finger and Andrzej Olechowski,[5] in a paper, "Trade Barriers: Who does What to Whom", suggest that in world trade, free mobility of goods is restricted by advanced countries with the help of four instruments -- Quantitative Restrictions, Voluntary Export Restraints, measures to ensure decreed prices, tariff type measures and monitoring measures.

So, one would not be mistaken in stating that there is a degree of widespread acceptance that trade protectionism by the advanced countries, and especially by the EU, is a reality. But much of the analysis till date is found to be sectoral analysis. A comprehensive and all-encompassing coverage of the issues involved is found to be lacking. The present study is an attempt in the direction of removing this deficiency. It tries not only to incorporate as many areas of European protectionism into its analysis, but also tries to bring to the fore the up-to-date tactics of the European protectionist masters. The time period which is attempted to be covered through the study is quite vast. It includes a study of not only the pre-WTO protectionist policies, regimes and institutions but also those of the WTO era.

If the theories and models of economies were to be cent percent brought to reality, then the world would be a place of plenty and a place of well being. It would have been a fairy land. Contrary to theoretical depictions, in reality we have

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5 J. Michel Finger and Andrzej Olechowski, "Trade Barriers: Who Does What to Whom", in Herbert Giersch, n.1, pp.37-42.

distortions. So instead of the theoretical depiction of free trade, we have trade protectionism. The study covers the major theoretical frameworks on the field of free trade and protectionism including the latest 'one good cross-hauling model'. It tries to bring out clearly the negative effect of protection on world trade.

Every modern phenomena has a representative past and European trade protectionism is no exception. The first instance of an effort to provide effective protection to products of a group of countries within Europe was the Zollverein. The present study makes a detailed analysis of Zollverein and conclusively establishes the historical antecedents of European trade protectionism.

The legal framework of any country depicts, the community's sense of justice and fair play and trade laws too are beyond any exception. Faced with post-world war realities, European states were forced to devise strategies, to regenerate their domestic industries without compromising on global competitiveness. Protectionism was the way out. So they devised measures ranging from anti-dumping measures, quantitative restrictions, countervailing duties to inflated domestic subsidies. The wide spectrum of these measures and their impact on the world economy is brought out in the study.

Since the conclusion of the Rio-Earth Summit and the Kyoto Climate Change Summit, the issues concerning the Environment have dominated World Economics and Politics. EU saw in the newly emerging global environmental concern, a way to erect new trade barriers in front of the outside world. Environmental standards and norms have emerged as the most potent instruments of discriminative trade. A wide variety of these tools ranging from packaging regulations, to waste disposal regulations to product composition regulations have been studied in the present effort.

India's engagement with European countries is steeped in antiquity. Starting with a colonial pattern of engagement, it graduated to a dependency type of relation, and now to a multiple and broad based pattern of trade relation. In spite of the highly unequal pattern of trade relation between the two, protectionist measure have played their role in spoiling any possibility of a smooth relation. The study analyses the multiple factors hindering the possibility of smooth trade between the two. It also studies the newer barriers of concern to India.

Finally, the object of the study is also to bring home the serious nature of European protectionist barriers. It is aptly said, "the more you sweat in peacetime, the less you bleed in the battlefield". Until and unless the countries outside the EU, and especially the developing countries, understand the nature and consequences of European protectionism, combating them at the level of multilateral policy making as well as at the European markets would indeed be a very difficult task.

Chapter 1
INTRODUCTION

The European Union has emerged as the world's foremost economic and political grouping. It has emerged not only as a region with a very high standard of living, but also as a trading power house. In its efforts to gain an upper hand in its bilateral trade with its partners, it has, covertly as well as overtly, followed policies which are blatantly protectionist in character. While on the one hand, European protectionism has sought to strengthen the dependency syndrome of the Least Developed Countries of the world, it has also helped the European Union to hold its balance against other advanced countries which enjoy comparative advantage in a variety of fields. A study of the nature and forms of European Union's protectionist policies is of paramount importance not only for the world's advanced countries, but also for the less developed countries so that they may frame policies which circumvent the protectionist policies of the Union. With the emergence of the World Trade Organization, the Developing countries have got a new forum where, they can systematically expose the protectionist policies of the European Union and claim relief for the trading wrongs done to them. But this could be realistically possible only if a large scale reform of the organization is initiated, to bring about a balance between the developed and developing countries.

THE EUROPEAN UNION

The beginning of the journey towards building a full fledged European Union began in May 1950,[1] when Belgium, France, the Federal Republic of Germany, Italy, Luxembourg and Netherlands started negotiating with the aim of ensuring continual peace by merging their essential interests. This was considered as important in the light of their experiences during the past half a century. In 1951 they signed the Treaty of Paris creating the European Coal and Steel Community (ECSC).[2] When it was clear that it was impossible to create communities covering Defence and Foreign Affairs, the members went forward and created the European Economic Community (EEC) and the European Atomic Energy Community (EURATOM) in 1957[3] by the Treaty of Rome.

On 1 January 1973, United Kingdom, Denmark and Ireland joined the union as full members. On 28 May 1978, the Greek Treaty of Accession was signed and Greece joined the EU on 1 January 1981. Spain and Portugal joined on 1 January 1986 and Austria, Finland and Sweden joined on 1 January 1995.[4]

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1 Chris Cook and John Paxton, *European Political Facts, 1900-1996* (New York: St. Martin Press, 1997), p.19.

2 Ibid., pp.19-20.

3 Ibid., pp.19-20.

4 Ibid.

The establishment of the European Union has always been the objective of European integration. A common analogy described the EU as the destination towards which the European Community train was moving. But EU was an ill-defined terminus. The Treaty of Rome called for "an ever closer union" among the people of Europe. The Paris Conference in October 1972 was famous for declaring, "the member states of the community, the driving force of European construction, affirm their intention before the end of the present decade to transform the whole complex of their relations into a European Union".[5] The European Council in Stuttgart in June 1983, adopted a solemn affirmation on the establishment of the European Union. The Single European Act too affirmed that the ultimate aim of the European integration process was the European Union.

The European Parliament's Draft Treaty establishing the European Union was a coherent and reasonably detailed description of a putative EU. According to the Draft Treaty, EU was to incorporate the existing community institutional structures and competencies and also to include the field of foreign and security policy. The Draft Treaty for the first time mentioned the policy of subsidiarity with regard to national competencies.

In the late 1980s, the successes of the Single Market Programme, the growing support for Economic and Monetary Union (EMU) and the German unification led the member states to convene two intergovernmental conferences in the 1990s. The

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5 Quoted in Desmond Dinan, *Encyclopedia of the EU* (London: Lynne Rienner, 1998), pp.224-25.

Foreign Ministers of the EC's member states signed the Treaty of the European Union (TEU) in the southern Dutch town of Maastricht on 7 February 1992. This treaty is popularly called The Maastricht Treaty. In the treaty, the member states defined the EU and established it. The treaty declared that the EU is founded upon the European Communities and is supplemented by an Intergovernmental Common Foreign and Security Policy (CFSP) and also Intergovernmental Cooperation on Justice and Home Affairs. The treaty sets the objectives of the Union as:[6]

(a) to promote economic and social progress;

(b) to assert EU's identity on the International scene;

(c) To strengthen and protect the rights of EU citizens

(d) to develop close co-operation on justice and Home Affairs;

(e) to maintain in full, the existing community laws.

In 1996, an Intergovernmental conference (IGC) was held as mandated by the TEU.[7] In the IGC, the issue of the reform of the TEU came up. This was in the background of talks for future enlargement of the Union. The needed reforms were sought to be brought about through the Amsterdam Treaty. The treaty made deepening of integration among the members in a wide range of areas, possible. The major areas it dealt with were freedom, security justice, external policy, international peace keeping etc.

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6 Desmond Dinan, n.5, p.225.

7 Ibid.

The Common Commercial Policy:

With regard to EU's external trade policy, Article 3 of the Treaty of Rome specifies that the Union shall have a Common External Tariff and a Common Commercial Policy (CCP).[8] Article 113[9] of the Treaty of Rome states that the CCP shall include changes in tariff rates, trade agreements, cooperation agreements, export policy and measures to promote fair trade. In practice the CCP affects the flow of trade between EU and the rest of the world. It also covers trade in services in addition to goods.

However, the significance of the CCP has come down since the establishment of the Customs Union (CU). This is so because: (a) the growth of the CU fostered intra-trade relative to extra-trade, and (b) expansion of EC from 6 to 15 has internalised what was originally external trade. In 1955, intra-EU trade was 35% of total visible trade. But by 1988, it rose to 58%.[10]

Commonality of trade policy does not mean that all traded goods are treated equally. In fact whole commodity sectors are specially protected. It also does not mean that there would be no difference in the treatment of third parties. It is uniformity of treatment across internal members in relation to third parties which is

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8 Keith Penketh, "External Trade Policy" in Frank McDonald and Stephen Dearden, eds., *European Economic Integration* (London: Longman, 1992), p.147.

9 Ibid.

10 Ibid.

important. It is this which gives the Commercial Policy its Commonality. Even this commonality has only been sparsely attained in the Community.

The Customs Union aspect of the EC is the establishment of a discriminatory trading area. Article 110 of the Treaty of Rome aims at (rather ironically), the abolition of restrictions on international trade and the lowering of trade barriers. But this is one objective which the EC hardly tried to pursue. Many of the EC measures have been targeted at legitimate trade involving foreign goods. A few instances may be worth noting here:

(a) In 1989, the US Secretary of Commerce protested against the Commission's proposal to pursue a non-EU broadcasting content of less than 50%.[11] This was clearly a step in the direction of creating a 'Fortress Europe'.

(b) In early 1980s, a memorandum submitted by the French government to the European Council linked industrial policy in the EC to lowering internal barriers but raising external barriers. Thus it becomes clear that the EC has not remained true to its own founding principles given in the Treaty of Rome.

PROTECTIONISM - A THEORETICAL PERSPECTIVE

Protectionism is a burning issue in world trade. While the developing countries of the world can be justified for adopting protectionist policies to tide over their cumulated disadvantages inherited from their colonial past, the phenomena of first world protectionism cannot be justified.

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11 Ibid., p.148.

The term Protectionism refers to a policy whereby domestic industries are to be protected from foreign competition. The aim is to impose restrictions on the import of low-priced products in order to encourage domestic industries producing high-priced products. The domestic products are protected by various tariff and non-tariff barriers which discriminate against the foreign products either in terms of their prices or quality. Yet the fact is that protection to the domestic industries of the advanced world works in the direction of negating many of the advantages which would otherwise have accrued to the nations through free-trade. This would be clear from the following study of free trade.

The Case for Free Trade

International trade is beneficial to all countries because it allows countries to buy and consume those goods which it cannot produce or can produce only at a high cost. It also enables countries to produce and sell goods which do not have an internal market, but can fetch a high price abroad. A Free Trade Policy is characterised by the "absence of tariffs, quotas, exchange restrictions, taxes, and subsidies on production, factor use and consumption". This policy of free trade implies complete freedom of International Trade without any restriction on movement of goods between Countries. However, even under free trade, there are provisions for customs duties and the like, implying that tariffs can be imposed, provided they are not protective and inhibitive. Eg:- If the government imposes a duty of 15% on a foreign produce which enjoys a cost advantage equivalent to more than 15%, it cannot be called as discriminatory since its domestic advantage remains intact. But if a 15% duty is

imposed on a foreign produce which enjoys less than 15% cost advantage over a similar domestic product, then its performance in the domestic market would be adversely affected.

Free trade offers many advantages to the world economy[12] as narrated below:

(a) *Maximisation of Output*

The case for free trade arises from the theory of comparative advantage, which states that under free trade, a country specialises in the production of those commodities which it is relatively best suited to produce and export than in exchange for those imports which it can obtain more cheaply. This maximises output of all the countries engaged in trade, because each concentrate on its most advantageous line of productions. This also raises the real national income of the world Economy.

(b) *Equalisation of Prices*

Free trade works towards the equalisation of commodity and factor prices the world over. The Heckscher - Ohlin - Stopler - Samuelson and such similar models have pointed to this theoretical possibility. But this can occur only in the absence of protectionist obstacles.

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12. Jhingan, M.L., *International Economics* (New Delhi: Konark Publishers, 1986), pp.154-55.

(c) *Optimum Utilisation Of Resources*

Free - trade leads to international specialisation and decision of labour. As a result, the existing resources in each trading community are employed more productively and resource allocation becomes more efficient. Even within the firm and the industry, allocation becomes more efficient.

(d) *Optimisation Of Consumption*

It benefits the consumer, when he is able to buy a variety of commodities from abroad at minimum possible prices. This in turn raises his standard of living.

(e) *Educative Value :*

According to Haberler, free trade has an educative value. International trade encourages home producers to sacrifice leisure in order to increase productivity. For this they innovate and bring improvements in organisation and methods of production.

(f) *Transfers:*

Free trade makes it possible to effect transfer of payments from debtor countries to creditor countries through commodity movements.

(g) *Prevents Monopolies:*

Under free trade, each country specialises in the production of a few commodities and the firm or industry are of optimum size, so that cost of production

of each commodity is minimum. Thus free trade ensures a lower price for exports as well as imports and the price mechanism under perfect competition prevents the formation of monopolies.

Protectionism and The Negation Of Free Trade Advantages:

The effects of protectionist policies are given under Eight heads.

(a) *Protective Effect*:[13]

Policies of protection inhibit foreign imports and unduly protect domestic industry by providing them with a secure market. The following diagram illustrates this.

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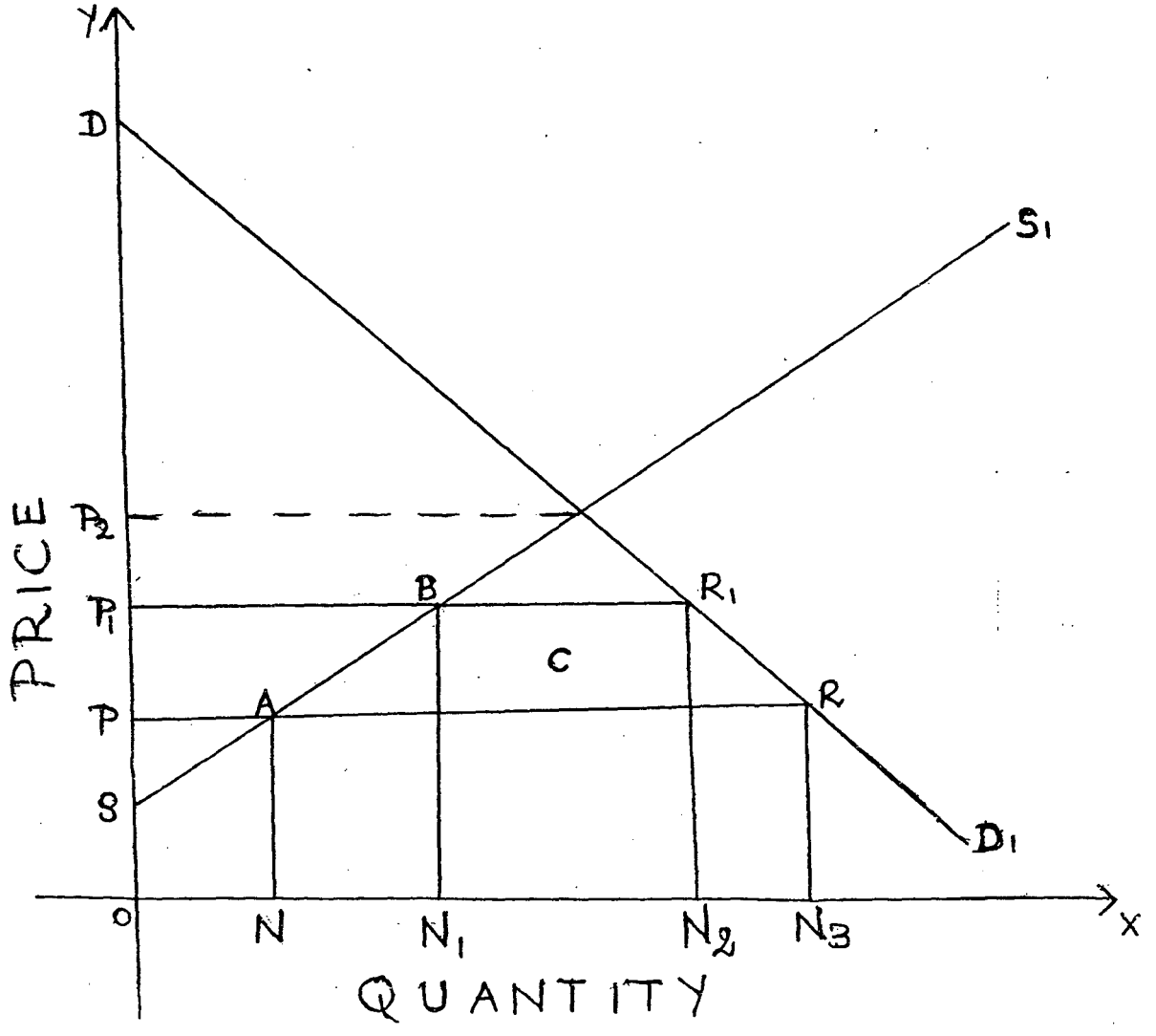
13 K.P.M. Sundharam, *Money, Banking and International Trade* (New Delhi: Sultanchand, 1977), pp.4-44.

Figure 1: **Protective, Consumption, Revenue and Redistributive Effects of a Tariff**



In the figure DD_1, and SS_1, are the demand and supply curves respectively. OP is the initial price. At this price, ON_3 is the total demand for the product, part of which is met by internal supply (ON), and the rest by import (NN^3). Suppose, the government imposes a tariff equal to PP_1, the new price after the tariff is OP_1. The new demand now is ON_2 which sees an expansion of domestic output from ON to ON_1 and now only N_1 N_2 is supplied by foreign producer. The expansion of output by NN_1 is known as Protective Effect. It may also be called the import substitution Effect as foreign production is substituted by domestic production. The size of the protective effect will depend on the elasticity of the supply curve, i.e., the more elastic the supply curve, the larger will be the protective effect. When an advanced country gains through protective effect, by discriminating against the products from Less Developed Countries, (LDCs), it causes great harm to their economies.

(b) *Consumption Effect:*

The imposition of barriers to the entry of imports raises the price of imported goods. As shown in Figure A, the decline is to the tune of N_2 N_3. The loss of consumer welfare is given by the decrease in consumer surplus to the tune of P P_1 R_1 R. Therefore consumption effect is generally negative due to tariff imposition. This policy is generally aimed at allowing domestic entrepreneurs to enter industries which are subject to increasing returns or decreasing costs. These firms may develop fast enough, reduce cost of production and thus out compete former foreign firms which were earlier suppliers. The Common Agricultural Policy (CAP) was introduced

with such an aim. Thus both the consumers and the low cost importers suffer in the process.

(c) *The Revenue Effect:*[14]

The government collects revenues through tariff duties. It is depicted by the rectangle C in figure 1, which indicates the Revenue effect. It is given by tariff duty per unit X No: of units imported i.e., here it is P P_1 X N_1 N_2. Based on the purpose of tariff imposition, tariffs may be divided into 2 - Protective duty and Revenue Duty. If the aim of a tariff is to gain protection against foreign competition, it is the former, but if the aim is only to collect revenue, it is the latter. In the case of the former, the tariff can be used to cut off imports altogether (PP_2 in the figure).

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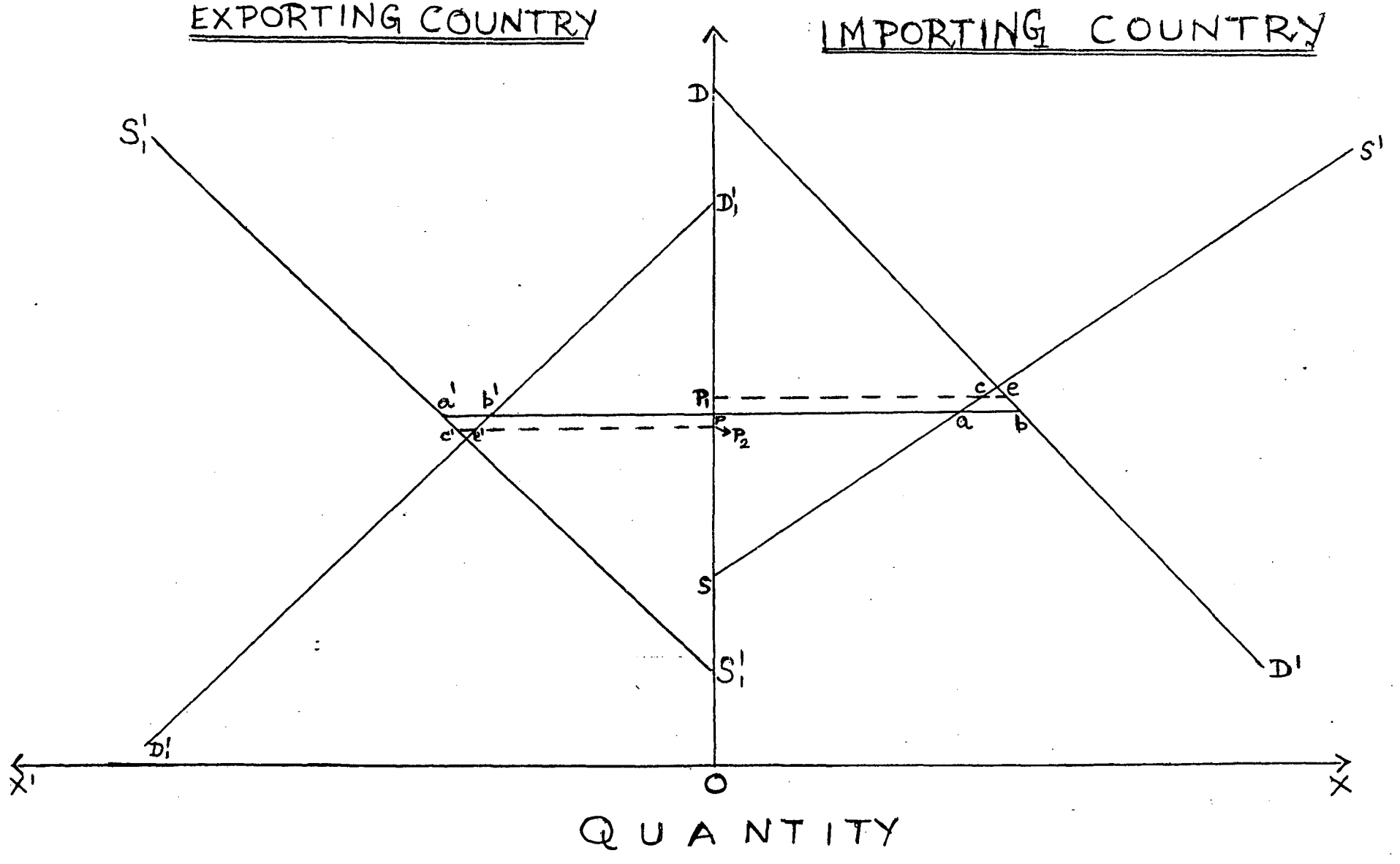
14 P.H. Lindert, *International Economics* (New Delhi: Sanjeev Printers, 1989), p.128.

Figure 2: *Relative Effects of Tariffs on Importers and Exporters*



(d) *Redistribution Effect:*

The higher price of the product due to the imposition of tariff will benefit domestic producers at the expense of domestic consumers and foreign producers. It involves a transfer of income from the consumers to the producers. This income accrues to the producer in 2 ways -- (a) the existing pre-tariff producers will get a higher income (price) after tariff is imposed and therefore get a higher profit and (b) the marginal producers producing N_1 N_2 will get a price higher than their supply price, and hence get a rent. The area "A" becomes an addition to producers surplus to producers. In general, tariff will redistribute income among scarce factors by raising their prices. The demand for tariff is often an attempt by scarce factors to reduce trade and improve their monopoly conditions. [FIGURE-1]

(e) *The Terms Of Trade Effect:*

At the national level, the basic argument in favour of tariffs is that they generally have a favourable effect on terms of trade[15] i.e., the tariff levying country finds it cheaper to import goods from other countries or in other words, a part of the tariff may be shifted to foreigners, thus adversely affecting the payments position of others (when imposed on LDCs).

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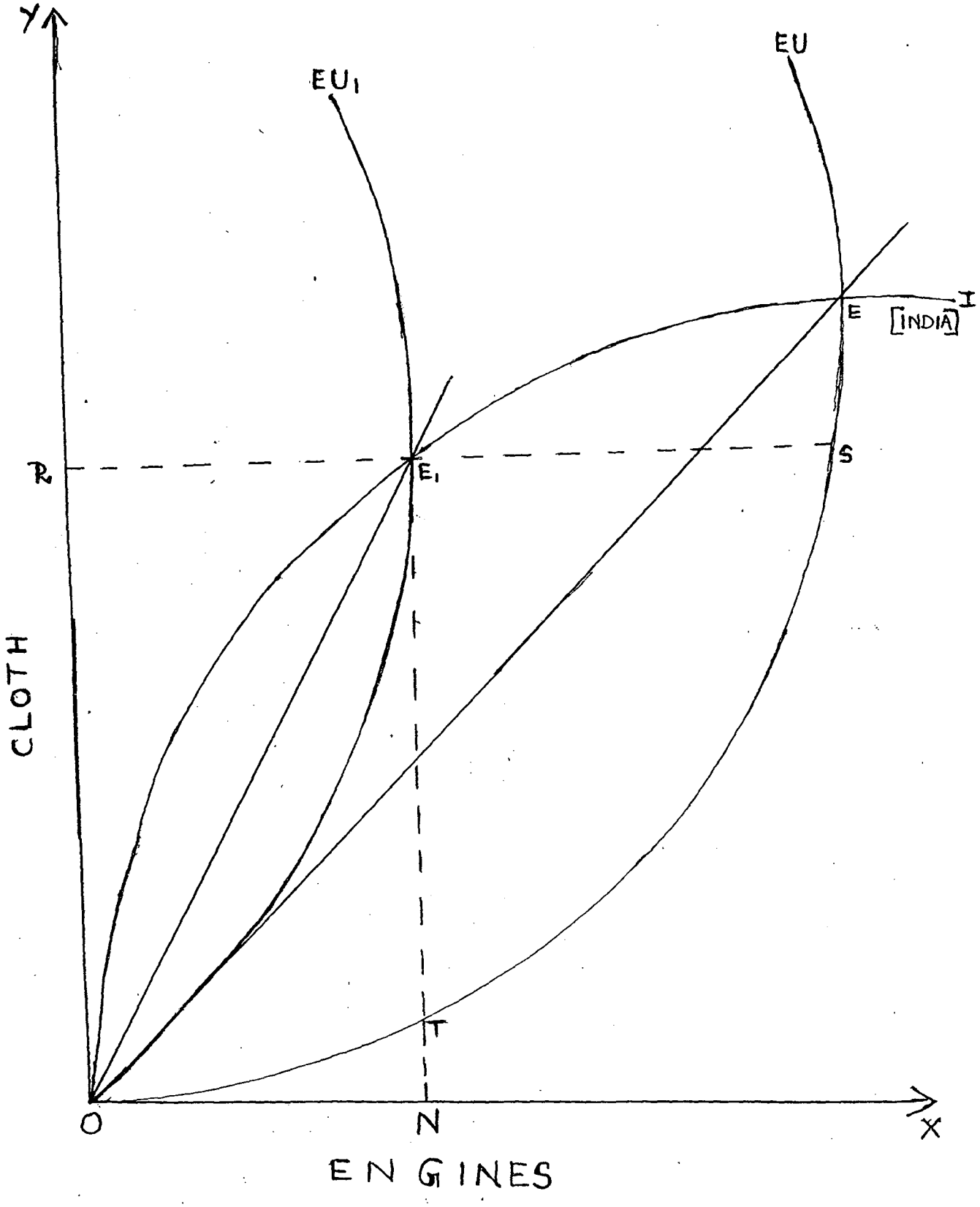
15 G. Bannock, *Dictionary of Economics* (London: Penguin, 1998), p.407.

With free trade, the prices of product would have been 'P' with imports of 'ab' and exports of a_1 b_1 for the importing and exporting country respectively (ab = a^1 b^1). The imposition of the tariff raises the price of the commodity in the importing country by P P_1 and thereby reducing the volume of imports. This depresses the price condition of the exporting country to OP_2. When the tariff imposing country is a developed country and the exporting country is an LDC, such a measure can seriously affect the Balance Of Payment Condition of the latter.[16] [FIGURE -2]

16 For other details see, P.B. Kenen, *The International Economy* (New Delhi: Prentice Hall, 1989), pp.174-81.

Figure 3: **Terms of Trade Effects of a Tariff**



The effect of a tariff here is to raise the price in the importing country and reduce the price in the exporting country. In other words, the importing country get the commodities cheaper. The incidence of the tariff can be completely shifted to the exporting country, if the supply curve in the exporting country is inelastic and the demand curve in the importing country is elastic. The inelastic supply curve is found in the case of LDCs whose exports are basically primary goods.

The Marshallian Offer Curves can be used to explain the terms of trade effect of a tariff. Here,

[FIGURE - 3]

OEU = EU's offer curve of Engines for Cloth

OEU^1 = EU's offer curve after imposition of tariff

OI = India's offer curve of cloth for Engines.

Before the imposition of the tariff, the offer curves intersect at the point E. The terms of trade between engines and cloth is given by OE. If EU imposes a tariff on cloth imported from India, EU's new offer curve will be OEU^1. The new offer curve has 2 major implications.

(a) While offering ON quantity of Engines, EU will now demand NE, quantity of cloth instead of NT quantity which would have been demanded under the old offer curve from a similar situation.

(b) For OR cloth from India, EU will now offer only RE engines instead of RS engines.

It is thus clear that the terms of trade OE, is more favourable to EU.

(f) *Competitive Effect:*

The imposition of tariff to restrict foreign competition, makes the domestic industry monopolistic. Sheltered behind the tariff wall, protected and inefficient industries may thrive. It helps in creating artificial profitability in industries which under free trade cannot claim comparative advantage. This effectively denies the emergence of international specialisation based on comparative advantage and hence hinders balanced expansion of world trade. On the other hand, consumers themselves may find it advantageous, if the tariffs are removed. Kindleberger calls this the Competitive Effect of a Tariff or more correctly the anti-Competitive Effect.

(g) *The Income Effect:*

The imposition of tariff and the consequent high price of the imported goods, reduces the expenditure of a country on foreign goods. Cut in expenditure on foreign goods may mean increased expenditure on domestic products. Under conditions of less than full-employment and under-utilised resources, there will be increase in money and real incomes. But in the developed countries which mostly work under conditions of full-employment, the increased expenditures would raise money income and not real income. The influence of tariff on income is known as income effect of a tariff. But the fact is that increased domestic expenditure results in decreased expenditure on foreign goods. The favourable income effect in the importing country may be offset by an unfavourable income effect in the exporting country.

(h) *Balance Of Payment Effect:*

Tariffs influence balance of payment (BOP) either favourably or unfavourably. For the tariff imposing country, tariff will restrict imports, and therefore normally that country will experience a favourable BOP effect. On the contrary, the country which is at the receiving end will find a deterioration in terms of trade and hence in the BOP situation due to tariff imposition. For a LDC with scarce foreign exchange resources, such a scenario may spell doom.

Political Economy Angle of Trade Protection

The question as to why a country accepts protectionist trade practices has generated interest among the political economists from the 1950s onwards. The subject was systematically brought to the fore by Kindleberger[17] in 1951. He compared the responses of a number of European countries to the agricultural depression of 1870. He found that while certain countries adopted protectionist policies, others remained fairly open.

For many people and in terms of traditions of many countries, some degree of protectionism seems quite natural. The most commonly asked questions, in this context, are: "Why should we import those goods, which we can produce at home?", "Why should we reduce domestic employment, to help foreigners sell?", etc.

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17 As quoted in W. Max Corden, "Why Trade is not Free: Is there a Clash between Theory and Practice?", in Herbert Giersch (ed.), *Free Trade in the World Economy* (Tubingen: Institut fur Weltwirtschaft an der Universitat Kiel, 1987), p.8.

One valid observation seems to be that protection tends to increase when there are shocks, which would otherwise lead to decline of particular industries and which would impose severe losses on particular sectors of the population.

Again during depressions or recessions, there is an increase in protection. Similarly during a war, foreign supplies of imports are cut off or reduced and unplanned infant industry protection is provided for domestic industry. For example, as a result of the Napoleonic wars, the English corn industry was protected through the 'Corn Laws'.[18]

Like any economic phenomena, protectionism also has two angles -- Demand and Supply. On the demand side, pressures for protection are likely stronger when there are more rents to lose in the absence of an increase in protection. Because of the concept of Diminishing Marginal Utility of Income, a given increase in income is valued less than a similar decrease, so that the interest groups will fight harder and spend more to prevent a decrease in real income than to obtain an increase.

On the supply side, it is the ideological factor which makes the society sympathetic to actual or potential losers. In most societies, there is an implicit social contract, whereby users are generally helped at the cost of others who must then forego some gains.[19] Most competitors accept the negation of gains, because they expect that this can be a justification for protection which could be provided by their

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18 Ibid., p.9.

19 Ibid., p.10.

home governments, when they are in trouble. But with regard to producers of developing countries, acceptance of losses are more due to the inability to protest.

The Political Economy Model of obtaining Protection (or the Baldwin Model)[20]

This model describes the profit maximising behaviour of a producer or a group of producers, organized in a lobby, who decide how much to spend to earn protection (represented by a tariff in Baldwin's presentation).

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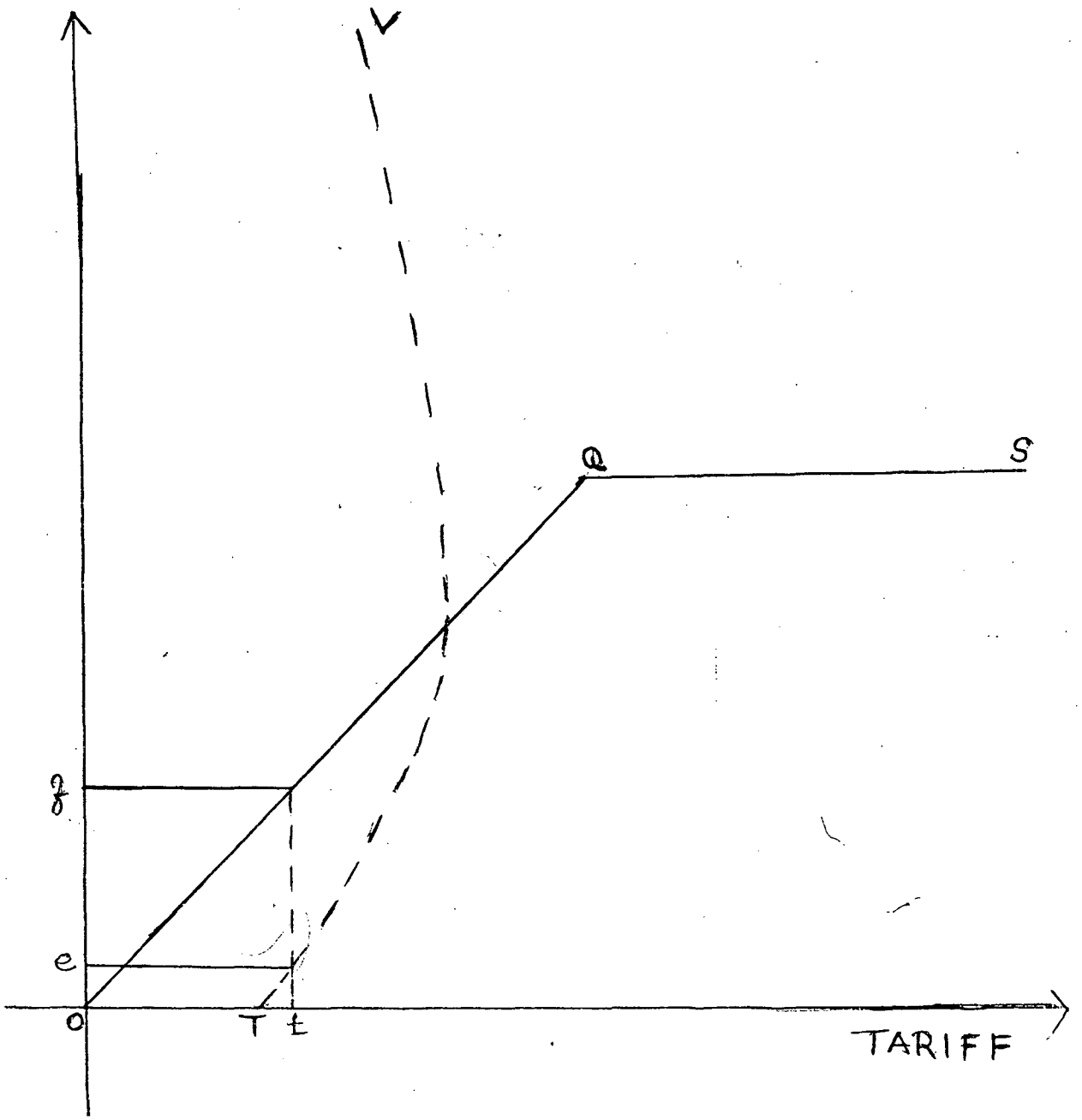
20 Jean Waelbroeck, "The Causes of Protection: From Economic to Historical Determinism?", in Herberrt Giersch, ibid., p.606.

Figure 4: Equilibrium in the Market for Protection



Curve O-Q-S in the diagram represents the extra-profits which producers earn as a result of protection which they secure. OTV represents the lobbying expenses that must be incurred by producers to obtain a given tariff. Tariff T will be given as a matter of general policy, even in the absence of lobbying. The tariff supply curve is initially flatter than the benefits curve and eventually becomes steeper than it. Maximum profit is earned, if an amount 'e' of lobbying is undertaken securing the tariff t. Lobbying earns the producers an extra profit -- a rent equal to e-f.

The Use of Competition Policy for Protection

Traditional discussions see governments as using devices like tariffs, quotas, voluntary export restraints to achieve protection. Competition policy can also be used to achieve the same end but, the type of intervention involved is not always advocated. For example, producers frequently exhort governments to go easy on domestic competition regulation to enable them to compete more effectively in foreign markets.

In this regard, Krugman (1984) advocated an important model.[21] He assumes a large producer in the home economy with a non-linear cost function

$$C = f(y) \text{---------- (i)}$$

which exhibits diminishing marginal costs i.e.,

$$\frac{af(y)}{ay} \text{ decreases with y.}$$

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21 J. Bliss, "Trade and Competition Control", in Jagdish Bhagawati and Robert Hudec, eds., *Fair Trade and Harmonization - Prerequisites for Free Trade*, vol.1 (London: MIT Press, 1997), p.320.

Krugman argues that import protection can promote exports. Tariff protection inhibits imports and gives the home producer larger share of home market. With constant marginal costs, these consequences would be the entire effect. Greater production for home market gives no advantage to the firm, when it exports to external markets. With diminishing marginal costs, however, sales to the home market and to the export market are no longer insulated from each other and determined separately. The larger volume of production for home market consequent upon the tariff makes the home firm more competitive in foreign markets. Therefore import protection promotes exports.

On the other hand, attempts to knock out producers in other countries are not just a theoretical possibility. There is the making of such a battle with the E.C. volume car makers. "Most experts agree that there is at least one too many of them to survive in the single market once national restrictions on free trade in cars are completely dismantled".[22] So it is tempting to ensure that some one else's industry goes to the wall.

The One Good Cross-Hauling Model[23]

Most of the results, which have come up for academic consideration are based on international trade between oligopolistic producers. One such model is the

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22 Ibid., p.321.

23 Ibid., pp.321-23.

Crosshauling model which allows for consideration of trade in identical products in both directions.

Every seller attempts to equate net marginal revenues in each market (i.e., domestic and foreign), by shifting sales between markets. A producer reaches an equilibrium in a market, if he does not wish to change the amount he is selling in the market given, how much others are selling. In standard terminology, this is called *Nash-Cournot equilibrium*. Producers are treated as if they have definite capacities and choose outputs unconstrained.

The producer also chooses a capacity level, sufficient to provide for all the markets, in the knowledge that price competition will drive production up to total capacity when marginal profitability of unit sales is equated across markets. Given this model, the following results may be obtained:

Result 1

When all sellers in a market are in Nash Equilibrium level of sales, market shares are inversely related to marginal costs of producing the product. This applies when more than one producer sells in the same market. Cetris Paribus, more producers mean more sales. It implies that policies aimed at increasing the equilibrium number of domestic producers are import substituting and export promoting. Here, an important assumption is made, i.e., all producers in all countries have constant marginal costs, because a higher marginal cost implies a lower market share. So the cost function must be

$C = \infty + my$ ---------- (2)
C = Total cost
Y = Level of production
∞, m = Constants

Result 2

Given an international equilibrium of many oligopolists inter-penetrating the markets of many countries, replication of one type results in:

(a) an increase in the share of the domestic market, taken by home producers of the country, whose producers were affected by replication

(b) an increase in the share of home sales into each foreign market in which replicated producer was previously selling, and

(c) a fall in the market price in each market into which the replicated producer was previously selling.

Tariffs by increasing the cost to foreign sellers of selling into home market, protect home oligopolists. Thus any policy which increases the number of firms under constant marginal costs, promote exports, while any policy which that promotes or allows a decrease in the number of firms promotes exports under falling marginal costs.

The above analysis clearly illustrates the fact that Protectionist measures adversely affect world trade. Though LDCs have a case for a minimum level of protection, the rate of growth of world income will be seriously hurt if the "rich men's club" adopts similar tactics. What is more, a degree of protectionism has been built into all trade regulating institutions. This aspect shall be discussed in the analysis which follows.

GATT-WTO AND THE DEGREE OF PERMISSIVENESS TO PROTECTIONISM

Both the GATT and its present successor - the WTO have shown a great degree of tolerance to protectionism. Both contain a series of provisions which can be effectively used to justify protectionist measures adopted by various countries, especially the advanced ones. Here we shall examine a few of them.

(a) *Customs Union (CU) And Free Trade Areas (FTAs):*[24]

The single major provision which has been used to the advantage of Europe Union (EU) is the one relating to the Customs Union and Free Trade Areas (FTAs). GATT framework allows an interim arrangement which leads to a Customs Union (CU) or Free Trade Areas. According to this provision, it is allowed to depart from basic GATT especially MFN, for a reasonable period of time. This allows for a different tariff structure within the customs union and FTA compared to what exists with other countries.

In a Customs Union, tariffs operate at two levels.

(a) GATT-bound tariff levels for GATT members and (b) tariff - free treatment for CU goods. This provides protection to industries within CU/FTAs.

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24 For more details see, R. House, and Trebilcock, *The Regulation of International Trade* (New York: Routledge, 1995), pp.73-85.

(b) *Transhipment Issue*:

Suppose that tyres are exported from country A to country B and then from B to C after making some modifications. Suppose again that a tariff of 10% operates between A and B and that between B and C 8% (since B may be under the GSP scheme). Then tariff rebate shall not be extended to the tyres unless substantial transformation has been made to the product. But the problem is that GATT did not specify what substantial transformation meant. This lent room for arbitrary interpretation and hence for protection.

(c) *Government Procurement*:

Art 3(8) of GATT specifies that government procurement policy shall fall outside GATT.[25] It includes all those goods, which the government procures not for resale, further production, etc. In these cases, it can prefer a domestic producer over a foreign producer. It generally operates at 2 levels.

(i) In these cases, the tender period is kept very short, mostly to the advantage of the domestic producer; and

(ii) Specific stipulations regarding quality are often made, which are to the advantage of the domestic producer.

Such diversions from mainstream trade assume significance in the light of the fact that in 1991, a country like USA had around 20% of its trade in these lines calculated at over $1 trillion. This is of substantial harm to the LDCs.

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25 GATT, "Basic Instruments and Selected Documents", Geneva, March 1969, p.7.

(d) *Issue Of Technical Standards*:

As an exception to GATT's national treatment clause and the provisions relating to general elimination of quantitative restrictions, it is suggested that import restrictions necessary for the application of standards for classification, grading or marketing of commodities shall be adopted. In these cases, a country may have tested the goods according to its own standards, but retests may be ordered by the second country, causing delays and thereby assisting domestic producers. Eg:- Japan has often, in the past rejected products citing problems regarding standards. In the Tokyo round, it was 'stipulated that parties should support standard-related measures with scientific evidence and that these should not be imposed to create obstacles to trade.

(e) *Safeguard Clause*:

It is a major clause which allows departure from GATT obligation. Art 19 of GATT states that in cases of unforeseen contingencies or due to GATT provisions leading to such increases in quantities of imports of a particular product[26] so as to threaten or cause injury to a domestic industry in a like or competitive product, then restrictions could be imposed on its imports. The problem with this provision is that contingencies arising out of GATT provisions could lead to the withdrawal of any measure under GATT since it could be argued that the threatening spurt in imports has been caused by any particular provision including the MFN provision. Again Art

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26 Ibid., p.36.

19 did not spell out as to what constituted a threatening increase in imports (this was left to the state's interpretation). It also does not define what a serious injury is. If threat is defined broadly, then action could be taken even without an actual increase in imports i.e., preventive action. Again, it also does not specify as to what proportion of domestic producers should be hurt to justify the imposition of the measure.

(f) *General Exceptions*:

Art 20. of GATT allows restrictions on trade under the following clauses:[27]

(1) the protection of public morals

(2) protection of human, animal or plant life or health

(3) the importation and exportation of gold and silver

(4) ensuring the enforcements of laws or regulations in other countries which are consistent to the GATT.

(5) the conservation of exhaustible resources

(6) restrictions on the export of raw materials, to ensure that essential quantities are available to domestic producers. Prices may be artificially kept below world prices under a government stabilisation plan.

(g) *National Security Exception*:

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27 Ibid., p.37.

Under this clause, any action necessary to protect national security can be adopted. Since national security has a vague definition, it has been used for affording protection. Eg:- Pakistan has not given the Most Favoured Nation (MFN) status to India, citing this clause. Again the Helms Burton Act denied corporate visas to EU's corporate chiefs under this clause, claiming that they had link with cuba.

Protectionism under WTO has manifested itself in the following patterns. The WTO claims to be rule oriented. But its interpretative rules enable multiple adaptations which afford space for protection.

(h) *Anti-Dumping Provisions*:

One of the major clauses which affords protection is found in Art. 17(6) of the Anti-Dumping Code of WTO. It suggests that, if over a dispute, a country arrives at an interpretation using the prescribed scientific methodology for a problem, which is different from the one arrived at by the WTO panel of experts, then the former interpretation will be accepted.[28] This is a legitimization of protectionism, notwithstanding the verdicts of the world body.

(i) *Environmental Measures*:

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28 Trade Negotiations Committee, Agreement on Implementation of Article IV of GATT 94, "Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations" (Marrakesh, 15 April 1994), p.165.

Initially when the GATT rules were framed in 1947-48, environmental matters did not form major matters of concern Matters relating to the environment were dealt with under Art. 20, which consisted of General exceptions to GATT provisions. *Art 20 (B)* states that measures could be taken so as to protect human, animal or plant health. Art *20(G)* states that measures could be adopted to ensure conservation of scarce natural resources.[29] The only limiting aspect is that the provisions should not be arbitrarily applied.

In the WTO, concern for environment was expressed with reference to (a) Agreement On Technical Barriers To Trade (TBT) and (b) Sanitary and Phytosanitary understanding (SPS). TBT refers to the maintenance of technical standards of production which should be commonly observed by all the exporting countries. SPS relate to those provisions which aim at protection of health and prevention of rest related ailments.

The major problem with this scheme is that under Annexe 1 of the agreement of TBT, the definition of technical regulation is meant to include, "product characteristics or their related processes and production methods, including the applicable administrative provisions with which compliance is mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production

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29 GATT, n.25, p.37.

method".[30] Based on the above mentioned aspects relating to use of terminology, packaging, labelling etc, a series of protectionist measures can be instituted. Therefore GATT/WTO has effective control over Process and Production Methods (PPMs) related to commodities.

Apart from the two areas where the possibility for protectionism has been enlarged by WTO, the old areas of protectionism under GATT like the national Security exception, too have been carried forward. Moreover, WTO has also brought in new areas like agriculture and services under its purview, which were hitherto left outside GATT. For instance, in agriculture, the agreement on reduction of aggregate support for agricultural products has been fixed with their base year as 1986-88. But the fact is that this was the period in which the production of the major agricultural producer, i.e., the European Union, had reached a peak. Therefore there was an in-built bias against developing countries.

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30 Trade Negotiations Committee, Agreement on Technical Barriers to Trade, "Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations", Marrakesh, 15 April 1994, p.132.

Chapter 2

DOMESTIC ROOTS OF EUROPEAN PROTECTIONISM

The concept of providing protection to domestic industry through the creation of a preferential trading bloc is not new to European economic tradition. Its roots can be traced back to the 'Zollverein', which was a pioneering attempt at initiating German economic and political unity. The major advocacy for the 'Zollverein' came in Friedrich List's work - 'National System Of Political Economy",[1] or 'Das Nationale Systemder Politischer Okonomie'. In this book, he argued that nation state was the natural unit of economic production and that imposition of high tariff walls was necessary to foster German industries.[2] The Zollverein was in fact the result of a broader understanding of the realities confronting Germany on the economic field.

Economic Position Of Germany In 1815:

At the end of the Napoleonic wars, Germany showed few signs of economic progress. Though Germany possessed many of the conditions necessary for making rapid economic progress, its efforts were hampered by adverse geographic, economic, political and social factors. Both agriculture and industry suffered from geographical difficulties. Much of the North German plains were infertile. Improved mineral resource utilisation could not take place till improved transportation was available.

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1 James, J. Sheehan, *German History 1770-1866* (Oxford: Clarendon Press, 1989), p.500.

2 Ibid., p.501.

Other major difficulties hampering progress were the poor communication facilities within Germany, the lack of capital for investment in Industry, the survival of outdated social institutions and the evil effects of political division. Although, Article.19 of the Federal Act of 1815 provided that confederated states reserve to themselves, the right of deliberating upon the manner of regulating the commerce and navigation from one state to another the Federal Diet at Frankfurt took no step to organise German economic life.[3]

Prussian Economic Policy and Zollverein

Like other German states, Prussia suffered severe economic depression in 1815. Though she gained territories like Rhineland and Westphalia, they were all underdeveloped. Further the great distances between Mane on the East and Trier on the West, combined with poor communication and lack of territorial continuity between Western and Eastern provinces presented great difficulties. But Prussian state took active interest by negotiating trade treaties, by building roads and securing technical progress to overcome them. The most important step taken was the enactment of Maassen's tariff law of 1818. Under this tariff law, many internal dues were abolished and customs duties were now collected at frontiers which involved a loss of revenue but facilitated trade between Prussia's two separate groups of provinces. Most raw materials were admitted duty free, while manufactured articles paid only 10% import duty ad-valorem. These tariff levels made smuggling

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3 E.J. Passant, ed., *A Short History of Germany, 1815-1845* (Cambridge: Cambridge University Press, 1969), pp.64-70. Also see John E. Rhodes, *The Quest for Unity: Modern Germany 1848-1970* (New York: Holt, Rhinehart and Winston, 1971), pp.15-22.

unprofitable. On the other hand goods which crossed Prussian boundary paid Is.6d. a Cwt, a tax on international commerce, which was a useful source of revenue, as well as a weapon which could be used against small German neighbours.[4] It should also be noted that Prussia also had to face a stubborn Metternich who was determined to foil all chances of Prussia's economic prosperity.

The tariff law brought no immediate relief to Prussian agriculture or industry, but ultimately it facilitated economic expansion. Shortly afterwards, various small enhances were absorbed into Prussian Customs Union system. They accepted the Prussian tariff rates and received a share of the joint revenue based on population ratios.[5]

Customs Union

The existence of many different tariff rates were so inconvenient that several states undertook negotiations in 1820 for the formation of customs union. Three such customs unions were formed in 1828. The first was formed between Baveria and Wörttemberg. It fell short of the Great German Union which was originally planned. The second was between Prussia and Hesse-Darmstadt.

It was on the same lines that arrangements were made to include enclaves in Prussian customs system, except that Hesse-Darmstadt retained her own customs officials. The third was the Middle German Commercial Union which included Hanover, Brunswick, Saxony and several small states in Central Germany. It had no

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4 Ibid.

5 Ibid.

common tariffs and its object was to prevent Prussia from controlling the main roads from North Sea ports to the markets of Frankfurt-am-Main and Leipzig.But Prussia defeated the union plans. She facilitated commerce between north and south Germany by herself constructing roads through the principalities of Meiningen and Gotha from Prussia to Baveria, Wörttemberg and Frankfurt-am-Main and by taking the lead in negotiating with the Dutch for reducing tolls levied on shipping on the Rhine. This was the work of Motz who was the Prussian Finance Minister between 1825 and 1830.

PRUSSIA AND THE FOUNDATION OF ZOLLVEREIN

The Middle German Commercial Union collapsed under various blows. Hesse-Cassel deserted to the Prussian Customs system in 1831, and so an economic link was forged between Prussia's Eastern and Western Provinces. Saxony and Thuringen States followed suit. Meanwhile Prussia and other southern states were drawing closer together. In 1834, Baveria and Wörttemberg formed a customs union with Prussia and the two Hesses. The union -- the Zollverein -- had an area of 162,870 sq. km and a population of 23.5 million. Within eight years, it was joined by Baden, Nassau, Frankfurt-am-Main and Luxembourg. But Hanover, Brunswick and Oldenberg remained aloof and formed the Tax union, whilst the other states retained their economic independence -- Hamburg, Bremen and Lubbock, the two Meckleanburgs, Schleswig and Launburg. Between 1837 and 1844, Brunswick joined the Zollverein.[6]

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6 Passant, n.3, pp.65-69.

The establishment of the Zollverein was not the direct result of the rise of German nationalism. Many countries entered the Prussian customs system only because they could in no other way alleviate their economic embarrassment. They jealously guarded their sovereignty and prevented Prussia from gaining substantially from her position as the leading state in the Zollverein.

The Working of the Zollverein -- An Approximation

The advantage accruing from the introduction of a Zollverein type customs union[7] essentially emerged from the peculiarity of the arrangement.

(a) Participation of sizeable number of states in the arrangement;

(b) A reasonably large quantum of trade existed between the members;

(c) Introduction of common external tariffs combined with the removal of internal intra-participant tariffs; and

(d) Wide differences existed between the cost of production of specific commodities between member states.

The effect of the introduction of a Zollverein type customs union can be approximated as follows. Let us denote Baveria as country 'A', India as country 'B' and Prussia as country 'C'. In our analysis, Baveria specializes in the production of commodity X, while it imports good Y from India (which is a low cost producer). Before the introduction of the customs union, it imports 'B' at terms of trade AB.

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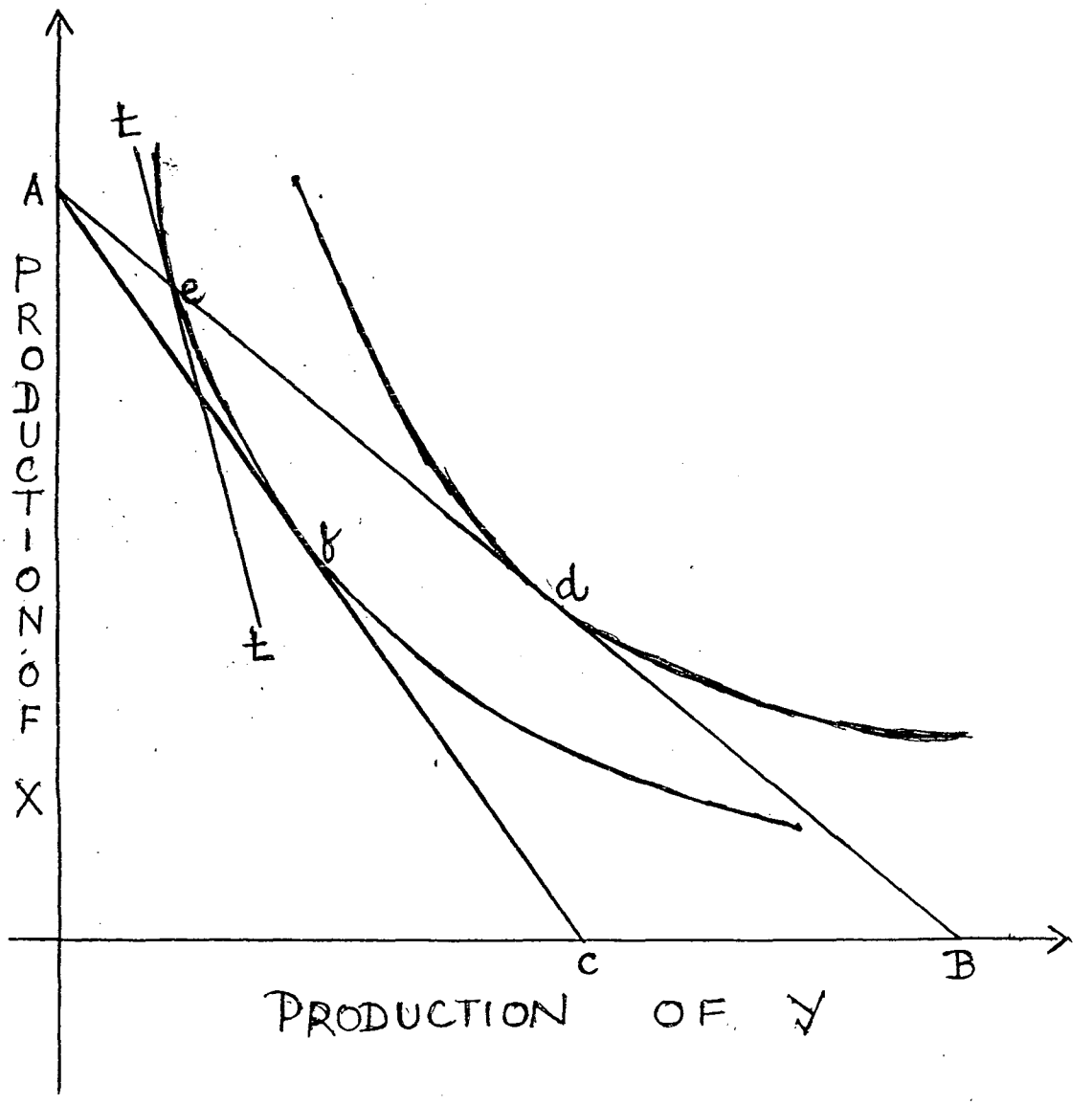
7 For a theory of Customs Union, see Peter B. Kennan, *The International Economy*, New Delhi, Prentice Hall, 1989, pp.201-09. For a General Equilibrium Understanding of the Customs Union see, M.L. Jhingan, *International Economics* (New Delhi: Konark Publishers, 1986), pp.211-28.

Figure 5: Diagrammatic Representation of the Working of The Zollverein



If free trade were permitted, consumption would be at 'd'. As the prelude to the formation of the customs union, country A (Baveria) imposes a steep duty on Y and the domestic price ratio is given by tt. Now consumption is at the point e. The tariff leads to a fall in consumption of Y. This lowers consumer's surplus/welfare. 'A' now forms a customs Union with 'C'. This leads to *trade diversion* and the worsening of A's terms of trade. The new terms of trade is given by AC. This need not mean a lowering of welfare for consumers because price ratio AC will now be ruling A's domestic market and Y is now cheaper than tariff inclusive price ratio tt. But all the same, he is worse off than the initial position, he had reached (i.e., 'd'). Now Y can be substituted for X and consumption reaches the point f. Before this the consumers were at 'e', which had large amount of X (due to the high price of Y). But the industries of the union countries gain in the absence of external competition.

Austria and the Zollverein

After 1850, Austrian statesmen were anxious to wrest from Prussia the economic as well as political leadership of Germany and an attempt was made by Bruck, who was the founder of Lloyd Shipping Company. He became the Austrian Minister of Commerce in November 1848 and was prepared to abolish the Austro-Hungarian customs frontier to reform the prohibitive Hapsburg tariff as necessary preliminary to the establishment of a Customs Union with Germany. Inclusive in his plan was an attempted economic unification of the Hapsburg Empire, the Zollverein, the tax union and those German states which still retained their economic integration. In the Hapsburg, support for Bruck's plan came from Magyar landowners, who

reckoned that success of the scheme would assure them a wider market. It was further supported by those manufacturers who did not fear German competition (cross elasticity of demand with German products being zero). German protectionists supported the scheme while the free traders opposed it. The southern states would have accepted it only if they got as much revenue from it as from the present arrangement under the Zollverein. Prussia was against it.[8]

Prussia strengthened its position by securing adhesion to Zollverein of Hanover and its associates. Hanover was given 75% more of Zollverein's revenue than was warranted by the size of her population. Now even if the southern states had deserted her, Prussia was at least assured of the economic control of Germany, north of Main. The southern and central states eventually reviewed the Zollverein treaties and no Austro-German Customs Union was formed.

Prussia had kept Austria out of the customs union and had absorbed the tax union. While in the political sphere Prussia lost out to Austria (O/Mutz), in the economic sphere she reigned supreme.[9] Further commercial negotiation in late 1850s between Prussia and Austria resulted only in the formation of a German monetary union which sought to fix relations between the country's three main currencies.

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8 E.J. Passant, n3, pp.64-70.

9 Ibid.

In 1862, Prussia made an Austro-Hungarian Customs Union impossible by signing a commercial treaty with France. Provisions were made for changes in the Zollverein tariffs; many import duties were reduced. In return, France agreed that imports from the Zollverein should pay duties at reduced rates as conceded to Britain and Belgium. While Saxony welcomed the proposed change in tariffs, Württemberg, Baveria and Hanover at first refused to agree with them and in 1862, Austria revived Bruck's proposal for an Austro-German customs union with far higher tariff walls than those suggested by Franco-Prussian commercial treaty. Prussia rejected this because it involved a loss of Prussian supremacy in the Zollverein. Bismarck appreciated the need to keep Austria out of the Zollverein. The southern states were brought to heel by giving them the choice between accepting the French treaty and leaving the Zollverein.[10]

Austria and Prussia came to terms in April 1865. Though the preamble of the treaty referred to a future 'general German Customs Union', no one seriously imagined that the union could now be achieved. The preferential duties of the treaty of 1853 were replaced by the Most Favoured Nations (MFN) clause and Austria surrendered her economic dominance to Prussia even before her military defeat.[11]

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10 Ibid.

11 Ibid.

Zollverein After 1866

The North German Confederation under Prussia, swollen by the annexation of Hanover and other German territories, was also a customs union, though Hamburg and Bremen, retained their economic independence (though members). The states south of Main, too joined the new Zollverein. The old general congress was replaced by a new Customs Council where decisions were taken by a majority vote. The Customs Council was established in 1868. But gaps still existed on the views about the economic needs of various constituents.

POSITIVE IMPACT OF THE ZOLLVEREIN

(a) Development of Communications and Shipping

The very nature of Zollverein necessitated the speedier development of communications and shipping. In the early 19th century, poor transport facilities, particularly East of Elbe, hampered economic progress. In the 1820s, Prussia embarked on a road building programme to foster industry and trade and to defeat the plans of middle German Commercial Union and thereby to strengthen the Zollverein. "At the same time, the extension and consolidation of the Zollverein, the general introduction of steam communication, the growing competition in home trade brought the commercial cases of different states and provinces close together, equalized their interests, centralized their strengths"[12] Over 2800 miles of roads were built between 1817 and 1828.

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12 F. Engles, K. Marx and Eleanor Marx (ed.), *Germany: Revolution and Counterrevolution* (London: Lawrence and Wishart, 1969), p.13.

Since roads were in poor condition, the Rhine and Elbe were used as means of transport. Since these rivers passed through various German states,it was not until the start of the smooth functioning of the Zollverein that the vexatious transit duties on these waterways were either substantially or totally removed.

(b) *Development of Railways*

Both the development of railways and the emergence of the Zollverein strengthened each other. They shook the nation out of its economic stagnation. The beginning of the Zollverein required the introduction of efficient systems of transportation for goods, raw-materials and humans. The first German railways were short suburban ones -- Nuremberg-Furth, Berlin-Potsdam and Brunswick-Wolfenbuttel. But in 1939, Dresden, the capital of Saxony, was joined to Leipzig, the chief commercial city of the Kingdom. At the end of 1846, over 2000 miles of railways were opened. By 1860s, trunk lines were complete. Three railway lines, linked Western and Eastern parts of Germany. Railways building fostered the growth of heavy industries -- for rails and sleepers had to be constructed, engines were to be built and coal had to be provided.

WAS ZOLLVEREIN A PRECURSOR TO GERMAN UNITY?

> Und ihr andern deutschen sachen,[13]
> tausend Dank sei euch gebracht!
> Was kein Geist ji konnte machen,
> ei dasabet ihr gemacht:

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13 James J. Sheehan, n.1, p.503.

Denn ihr habt in Band gewanden
um das deutsche Vaterland
Und die Herzen hat Verbunden,
mehr als unser Bund dies Band[14]

Many of the German intellectuals were thoroughly convinced that the Zollverein had brought economic and national awareness. They began to view it as a turning point to the emergence of Germany's industrial power and a unified nation. William Roscher called the Zollverein not only the most beneficial but also the greatest event in German history between Waterloo and Koniggratz. "At the same time the extension and consolidation of the Zollverein, the general introduction of steam communication, the growing competition in home trade, brought the commercial cases of different states and provinces closer together, equalized their interests, centralized their strength".[15] W.O. Henderson carried forward the tradition and stated that he had endeavoured to show that establishment of customs union and other developments, helped to prepare the way for subsequent political union of Germany.[16] The removal of trade barriers resulted not only in greater circulation of goods, but also of people and ideas. The very bases on which distinction between principalities were maintained were these internal tariffs.[17] The

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14 Hoffman Von Fallersleben, 'Zollverein', 1842 [In the poem he gives a litany of commodities -- 'Scheme febholzer, Feachel, Wicken, Wolle, Seife, Garn and Bier -- which he believed had done more to German unity than ideas of diplomacy].

15 F. Engels, K. Marx and Eleanor Marx (ed.), n.12, p.13.

16 Sheehan, n.1, p.503.

17 Ibid., p.503.

Zolvlerein did more for the spread of German culture than any cultural institution. Thus Zollverein did more to impart a sense of unity in the fatherland than any conventional instrument of diplomacy.

However, there are good reasons to be sceptical about this picture. While creation of a large market did create more commerce and also benefitted the enterprises, its impact on German unity is hard to measure. Frank Tipson has argued that the available statistical series fails to reveal any decisive shift which may be connected with the Zollverein.[18] The best one can say is that the Zollverein along with other factors such as rail-road construction helped to enhance growth. Further there were important limitations on Zollverein's economic cohesion. Since its members could not decide on how to tax government monopolies in tobacco, wine and brandy, these items could not move freely along state lines. Weights, measures and coinage remained different. Similarly Zollverein did not sever German connections with overseas markets. For example, most of Berlin's coal came from abroad. In the west of Rhine, textile manufacturers remained closely tied to Dutch enterprises, while everywhere else in the Zollverein, the influence of English products was present.[19]

There were two major weaknesses in the formation of the Zollverein.[20] First, unanimity and not a majority decision, was necessary for a

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18 Ibid.

19 Ibid., pp.503-04.

20 E.J. Passant, n3, p.68.

proposal to be passed by the Zollverein Congress. This 'liberation veto' was used by the smaller countries effectively against Prussia. Second, the original Zollverein treaties ran only for eight years after which they were to be renewed. So a dissatisfied state could extract benefits by threatening to walk out of the Zollverein.

Again, "the Zollverein was a step towards economic unity, but each state in Germany could still coin its own money, promulgate its own business laws, maintain its own weights and measures. Even the establishment of postal services and the building of railways required persistent negotiations between authorities".[21]

In short, the Zollverein was created by bureaucrats who were interested in fiscal and administrative reform rather than in nation-building. It created at best a common German market and not a German national economy.

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21 Irene Collins, *The Age of Progress: A Survey of European History from 1789-1870* (London: Edward Arnold Ltd., 1964), p.294.

Chapter 3

PROTECTIONISM IN EUROPEAN LAW

In the previous chapter, it has been made clear that protectionist tendencies have always existed in European countries. The present chapter shall focus on how the current European law hides within its beautiful wrapper, strains of protectionist tendencies. The attempt here is not to berate European law, which in itself is a creditable manifestation of European intellect, but to put it in the right perspective. In fact trade liberalization under WTO and the economic crisis in Asia and elsewhere has resulted in the increased use of protectionist measures by EU. India along with many other developing countries have been made their target. Given below are some of the common European trade practices.

(a) *Dumping*

Article 1.2 of European Union's basic Regulation states, "A product shall be considered as being dumped, if its export price to community is less than a comparable price for the like product, in the ordinary course of trade as established in the exporting country".[1] Therefore it considers export price less than 'normal

1 Vassilis N. Akritidis, "Overview of EC Anti-dumping and Anti-Subsidy Law and Practice" (New Delhi: Indian Society of International Law Conference, 19 February 1999), p.2.

price' as dumping. Dumping margins are expressed as percentages and calculated by the following formula.

$$\frac{\text{NORMAL VALUE -- EXPORT PRICE}}{\text{Export price at EU frontier, duty unpaid}} \times 100$$

All co-operating exporters receive individual dumping margins. Non-co-operating exporters are subject to residual dumping margins and some-times a penalty.[2]

A simplistic calculation of dumping margin is given below:

1.	Export Quantity	6 Mt.
2.	Export Price	Rs.10/Mt.
3.	Total Export Price (1x2)	Rs.60
4.	Unit Normal Value	20/Mt.
5.	Unit Dumping Margin (4-2)	Rs.10/Mt.
6.	Total Dumping Amount (1x5) (F)	Rs.60
7.	Average Unit CIF Export Price	Rs.15/Mt.
8.	Actual CIF Export Price (1x7)	Rs.90
9.	Dumping Margin = $\frac{Fx100}{H}$	$\frac{60 \times 100}{90} = 6.6\%$

For the purpose of calculating normal value, Article 2.1 of EU basic regulation states that, it is "the price paid or payable, in the ordinary course of trade, by independent customers in exporting country".[3] These costs may be calculated at ex-factory level, net of CIF costs in exporting country or other costs or sales

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2 Ibid., p.3.

3 Ibid., p.4.

commissions. It must also be representative i.e., equal to or greater than 5% of the export volume of EU. It must be disregarded if it is found to be non profitable. Transfer prices to related companies may be disregarded.

For the calculation of export price, Article 2.8 of EU Basic regulation states that the export price is "the price actually paid or payable for the product when sold for export from the exporting country to the community".[4] It should be calculated at ex-factory level, net of costs incurred up to the port of entry into EU. Transfer prices to related importers are disregarded. The weighted average is used as a measure of calculation of export price, if there is less of variance. Otherwise the calculation of Export price is made, transaction by transaction.

Regarding Adjustment allowances, Article 2.10 of EU Basic Regulation states that, "A fair comparison shall be made between the export price and the normal value. This adjustment shall be made at the same level of trade and in respect of sales made, as nearly as possible, at the same time and with due account taken of other differences which affect price comparability".[5] Allowances will be provided only after taking into consideration aspects such as physical characteristics, transport insurance, loading and ancillary costs, import charges and indirect taxes, packaging, credit, after sales costs, currency conversion costs, etc.

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4 Ibid., p.6.

5 Ibid., p.7.

A number of problems exist with such a blanket anti-dumping law. One of the major questions is as to how home market price should be arrived at. In certain cases very few goods of that particular variety may be produced at home. In such cases what kind of an average measure should be adopted.

Another major problem exists with regard to differences in accounting systems that exist between EU and non-EU countries. Again business methods may also vary widely between countries. All these make valuation for the purpose of imposing anti-dumping measures difficult and often inaccurate.

Moreover, there always remains the problem of in-built inequity of the international trading system. The more economically powerful nations like the nations of the union can have considerable impact on smaller and economically weaker nations[6] of the Third World like India. In fact EU is India's largest trading partner. This is again a major problem with these anti-dumping laws of EU.

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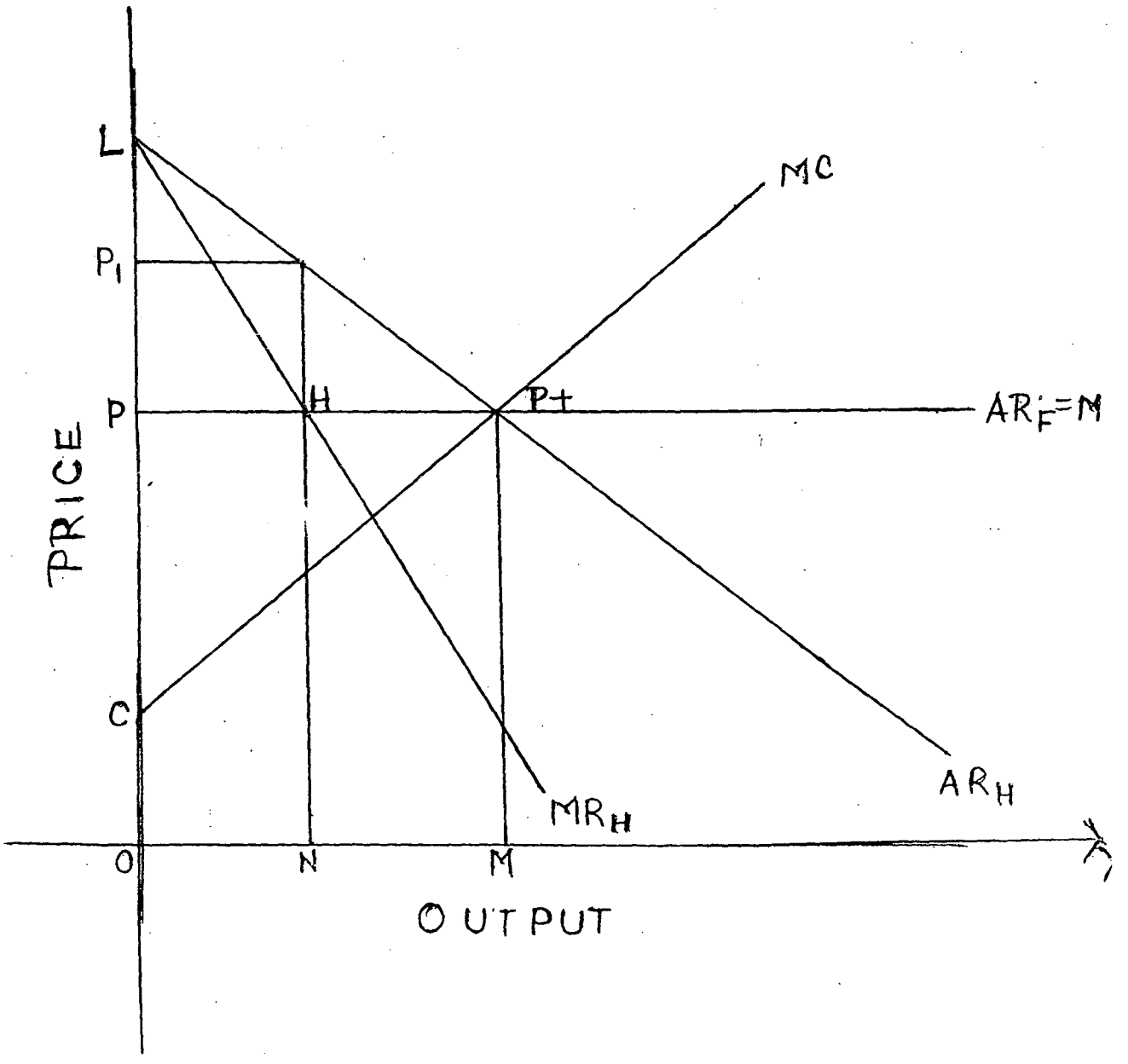
6 John Jackson, *The World Trading System: Law and Policy of International Economic Relations* (Cambridge: MIT Press, 1989), p.242.

Figure 6: Diagrammatic Representation of Dumping



The diagram illustrates a case in which a producer faces a monopoly market at home, but a competitive foreign market. In the home market, the demand curve for the firm will slope downwards. So does the marginal revenue curve. In the foreign market, where the producer faces perfect competition, he has a demand curve which is a horizontal straight line and the marginal revenue curve coincides with it.

Here,

AR_H = Average revenue curve at the home market

MR_H = Marginal revenue in the home market

AR_F = Average revenue in the foreign market

MR_F = Marginal revenue in the foreign market

LHP+ = Combined marginal revenue curve

MC = Marginal Cost curve

The marginal cost curve MC intersects the aggregate MR curve LHP+ at point P+ and equilibrium output OM is determined. The output OM is to be distributed among home market and foreign market in such a way that MR in the two markets is equal to each other and to marginal Cost MP (i.e., $MR_H = MR_F = MC$). From the figure, it is clear that the output sold in the home market is ON and the price charged is OP_1. The output sold in the foreign market is NM at a price of OP. Therefore, it becomes clear that under dumping, price of the product in the foreign market is lower than the one prevailing in the domestic market.

(b) *Quantitative Restrictions* (QRs)

The community had till 1990 about 700 QRs. Most of these, especially the ones used against Japan come under the exception of Article 36 of EEC. The European Court of Justice uses a two pronged Article 36 based justification test. Firstly, it checks whether the contested measure fits into one of the categories of allowable restrictions. Secondly, it determines whether the measure fails as arbitrary discrimination or distinguished trade restriction. Its basic objective is that national measures must not restrict trade any more than necessary to protect the interest in question. Article 115 allows for QR or measures having equivalent effect specifically designed to protect against trade deflection. Here the requirement of proportionality is paramount.

(c) *Subsidies*

The practice of governments, subsidizing the production of goods is widespread. These may be direct (given for trade reasons) or indirect (not specifically related to trade), but if it causes injury within EU, then it is regarded as an unfair trading practice and a countervailing duty may be imposed.[7] Here countervailability and not illegality under GATT is the issue. Timing of the subsidy is also an important aspect. An example for the calculation of subsidy margin is given below.

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7 Keith Peaketh, "External Trade Policy", in Frank McDonald, and Stephen Dearden, eds., *European Economic Integration* (London: Longman, 1992), p.153.

Passbook/DEPB (post export) sample Calculation[8]

Total Exports in POI EU	500
Other (Worldwide)	500
	1,000
Total Benefits during POI	
PB Debits	100
DEPB licence used	50
DEPB licence sold	50
	200
Interest @ 10%	20
	220

220 as percentage of 1000 = 22% subsidy margin

However, it must be noted that before subsidy duties may be imposed, the dumped product must be found to have caused material injury to the community industry producing the like product. Here injury is measured by many factors -- market share, undercutting, profitability, etc. Though it is specifically stated that a causal link must be established between the act of dumping and the fact of injury, such an establishment is not precisely scientific. Here the questions such as what a like product is, constitute part of the problem. It can be subject to differing interpretations. For example, a transistor and a two-in-one audio system is to be considered as like products. Moreover, in order to fight a case for establishing the

8 Akritidis, n.1, p.9.

wrongness of a measure, the foreign establishment is forced to fight in a legal system which is alien to it whereas it is purely indigenous to EU.[9]

(d) *Imports Producing Serious Injury to Domestic Producers -- The Case of VERs (Voluntary Export Restraint)*

VERs include binding agreements, non-binding agreements, gentleman's agreements, unilateral undertakings, forecasts of expected exports of one country to another, etc. These involve specific quantitative limits on exports. Before 1985, a country could establish, interim protective measures, but now these measures can be established only if an agreement is arrived at between a member state and a third country.[10] But the fact is that VERs are prohibited by Article XI of GATT which bans all restrictions other than duties and charges or other price based measures. It states, "No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, imports or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on exportation or sale for export of any product destined for the territory of any other contracting party".[11] It also violates Article 1 of GATT which calls for equal treatment of all trading partners. It states, "any advantage, favour, privilege or immunity granted by any

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9 Ibid., p.10.

10 Keith Penketh, n.7, p.154.

11 GATT, *Basic Instruments and Selected Documents*, vol.IV (Geneva, 1969), p.17.

contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.[12]

(e) *Surveillance*

Unilateral action can be taken in cases of surveillance. Evidence may be gathered prior to the establishment of a case for surveillance measures. Import licence may be required for the importation of certain imports under surveillance which nonetheless are not subject to limitation.[13]

(f) *Trade Deflection Measures*

Where imported goods are subject to quotas (e.g., textiles), an exporter subject to restriction may attempt to gain access to an EC country through the unprotected market of another. Restriction against deflected imports require application to the commission for authorization. Article 115 of the Treaty of Rome states that, "the Commission shall authorise member states to take the necessary protective measures, the condition and details of which it shall determine".[14]

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12 Ibid., p.2.

13 Keith Penketh, n.7, p.154.

14 Ibid.

(g) *Counterfeit Goods*

Responsibility for action here is left to national governments. Where evidence is positive, the goods may be disposed of or other measures taken of equivalent effect. Threatened industries often raise the bogey of counterfeit goods to avert competition.

Community Procedures Before Establishment of Punitive Measures

Before any punitive sanction is imposed on any trading partner, the Community makes it sure, in the interest of the Community as a whole that the contemplated measures do not cause any long term adverse impact. The Council looks into the implication of such measures from the standpoint of EU's political/industrial considerations. Prior to any such imposition, the views of user industries are alsc ascertained. It also has to take care for not coming into conflict with other Community laws, e.g., Anti-trust laws. The time-table and the scheme of procedure for investigation is given below.[15]

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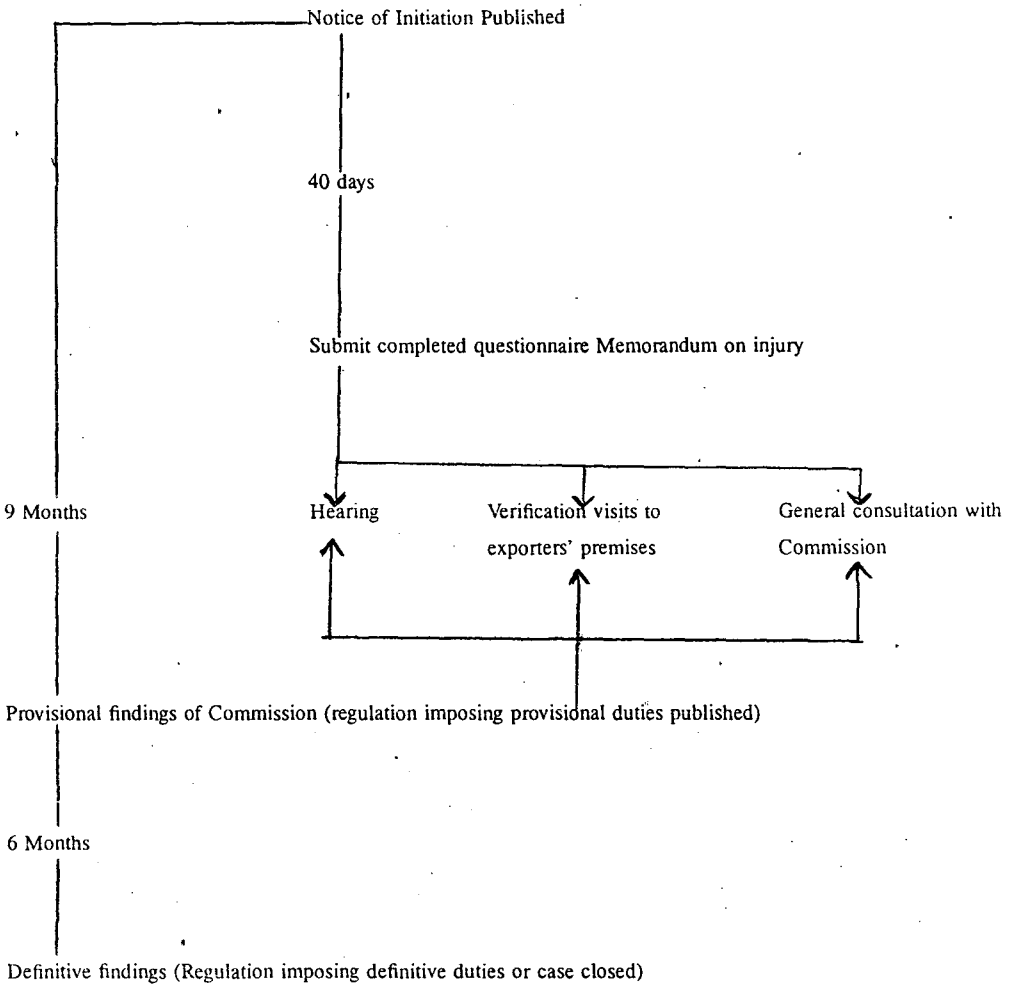
15 Akritidis, n.1, p.12.



Generally a questionnaire on injury would ask for the following information:

(a) General information (investigation period, product concerned)

(b) Product description

(c) Operating statistics

(d) Export of product concerned to the community

(e) Domestic sales of the product concerned

(f) Cost of production

(g) Profitability

(h) Allowances -- fair comparison

(i) Compensation of Normal value to export price

(j) Transaction by transaction listing

A memorandum on injury is soon initiated. For the success of this attempt, the co-operation of importers is vital. An intense research of EU market is undertaken with the active use of Eurostat trade statistics, internet etc. Then a careful examination of the details given in the complaint is done. Based on these studies maximum information is collected.

After the memorandum stage, hearing takes place. Hearing may be held any time after submission of questionnaire and injury memorandum and after provisional and definitive disclosure.[16] These sessions are very useful for understanding Commission's views. It is an opportunity to clarify positions and to submit additional arguments and documentary evidence.

After the above mentioned stage, provisional measures may be initiated. They may be imposed in many forms -- e.g., ad-valorem, minimum price, etc. They may be accompanied by industrial provisional disclosures. Specialized committees such as anti-dumping committees must be consulted beforehand. Duties collected must be kept in the form of bonds or bank guarantees.

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16 Akritidis, n.1, p.14.

Then comes the stage of definitive measures. The measures contemplated must be agreed upon by the concerned committee (like the anti-dumping committee). There is a possibility that political influence may be applied at this stage. Measures, when imposed, are taken by the EU Council, six to 9 months after provisional measures. Provisional measures involved are collected in definitive amounts. They will be in force for five years or until reviewed by other procedure.

Besides those measures, undertakings may be offered to the Commission on the particular trade matter at any time. If the undertakings are accepted, the Commission will suspend duties for individual companies. They may be offered in many forms -- price, quantity, or mix.

Fortress Europe Or a Level Playing Field?

It was widely hoped that the Single European Market (SEM) would be a level playing field. But recent developments within the Single Market and the Community have aroused fears that a 'Fortress Europe' is gradually being created. This fear has been largely expressed by representatives of larger Third Countries. Mr. R. Mosbacher, former U.S. Secretary of Commerce, was quoted as saying, "I am very disturbed by the signs of protectionism or 'Fortress Europe' that are beginning to appear".[17]

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17 Keith Penketh, n.[illegible], p.155.

The likelihood of more or less protectionism from European Union requires careful analysis. In the early 1980s, French President Francois Miterrand deplored the penetration of EC markets by high technology goods. His solution to enable Europe to reconquer its own domestic market was to lower internal barriers and raise external barriers. Again M. Thorn, former President of the EC Commission, asserted that Europe needed external protection for its advanced technology industries to enable them to attain international competence.[18]

The strengthening of SEM has effected the growth of intra-trade at the expense of extra-trade. The removal of the trade barriers between European countries through the establishment of the Single Market made internal trade among European countries more efficient due to the resultant standardization, enhancement of public procurement etc., but severely affected the prospects of foreign traders, especially from the Third World who were now faced with a higher common standard and unfavourable government procurement policies. Bird and Zeller predicted that the introduction of the measures explained in the previous pages would result in the eventual worsening of the current accounts of even the USA and Japan by a combined amount of $28 billion.[19] The growth of SEM and its unified policies have strengthened the trading balance of EC with the rest of the world and hence the trading balance of EC with the rest of the world has deteriorated. But it is hoped that the SEM and its policies would have a deflationary impact upon incomes in countries

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18 Ibid.

19 Keith Penketh, n.3, p.156.

outside EC. This relative income effect could stimulate imports into EC from outside which would ultimately work in favour of the rest of the world. However, such optimistic predictions can come true only if flow of trade into the European market were free. But in view of the numerous provisions within European law, which could be used to adversely affect the flow of trade, the distortion in favour of the European market could be considered to be of a long term nature.

Another influence which is automatic, and which occurred because barriers upon intra-trade have been eliminated, is the disappearance of Article 115 of Treaty of Rome. This Article is in part intended to prevent trade deflection and enforce residual restrictions under the GATT hard core waiver clause. The abandonment of internal frontier controls have made it difficult, if not impossible to monitor intra-EC trade. In fact O'Cleireacian had predicted in 1990 that regional quotas, allocated to member states under MFA or under Generalised System of Preferences (GSP), would be abandoned.[20]

Dornbush claims that the greatest threat to an 'Open European World Partner' is the social dimension. He states that the harmonization of labour market arrangements from job security to wages and social security benefits without proper regard for productivity differentials will make some countries uncompetitive,

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20 S. O'Cleireacian, "Gaps in EC's CCP", *Journal of Common Market Studies* (Oxford), vol.28, no.3, 1990, pp.201-17.

especially in relation to the outside world. This effect will produce calls for protection.[21]

In some areas EU industries have been found to be uncompetitive, e.g., in clothing and consumer electronics. Neuin claims that the rest of the world can only lose as a result of the dismantling of the internal barriers within the European Union, largely as a result of trade diversion increasing within the Union. Therefore he suggests that the Common External Tariffs should be massively reduced.[22]

The following would deal with a few instances of protectionism within the European Union which would indicate how deep is the problem of protectionism within EU.

PROTECTIONISM IN ACTION

SECTION A

A. THE COMMON AGRICULTURAL POLICY (CAP)

Agriculture has often been seen as standing in the way of the much heralded closer ties with Eastern Europe, as disrupting the smooth running of international trade and as hindering the birth of new community policies. The Common agricultural Policy contributes to uprooting people, moving traditional production elsewhere, degrading the environment, reducing the quality and uniqueness of farm products and

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21 Keith Penketh, n.7, p.156.

22 Ibid., pp.156-58.

distorting the delicate balance in the world trade of agricultural products. The CAP was introduced as community wide programme in 1969. As of today, it covers 90 per cent of Europe's farm output.[23] Its nature and mechanism of operation has not remained the same over time, but the protection of European agriculture from International Competition remains its foremost objective.

ESTABLISHMENT OF THE CAP

"There was a time when agriculture in Western Europe was most affected by changing seasons, the whims of climate and disease and the odd warring tribe".[24] When EEC was established in 1957, memories of food shortage were still fresh from the experience of Second World War. At that time Western Europe was only producing 80 per cent of its food requirements. Thus Article 39 of the Treaty of Rome declared the main objectives of CAP as follows:[25]

(a) to increase agricultural production

(b) to ensure a fair standard of living for the agricultural community

(c) to stabilise markets

(d) to assure availability of supplies, and

(e) to ensure that supplies reach consumers at reasonable prices.

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23 R.E. Davis, Baxter, and G. Bannock, *The Penguin Dictionary of Economics* (London: Penguin Books, 1998), p.66.

24 John Gibbons, "The Common Agricultural Policy", in Frank McDonald and Dearden Stephen (ed.) *European Economic Integration* (London: Longman, 1992), p.131.

25 Ibid.

For achieving the above said objectives, the following institutions were set up:

(a) the European Agricultural Guidance and Guarantee Fund (EAGGF) - to finance a price support system and development of the structure of European Agriculture.

(b) the EAGGF has a price *Guarantee section*, which operates through a series of target and intervention prices.

(c) the EAGGF also has a *Guidance section* which funds improvements in rural infrastructure so that the farmers may attain the goals of CAP.

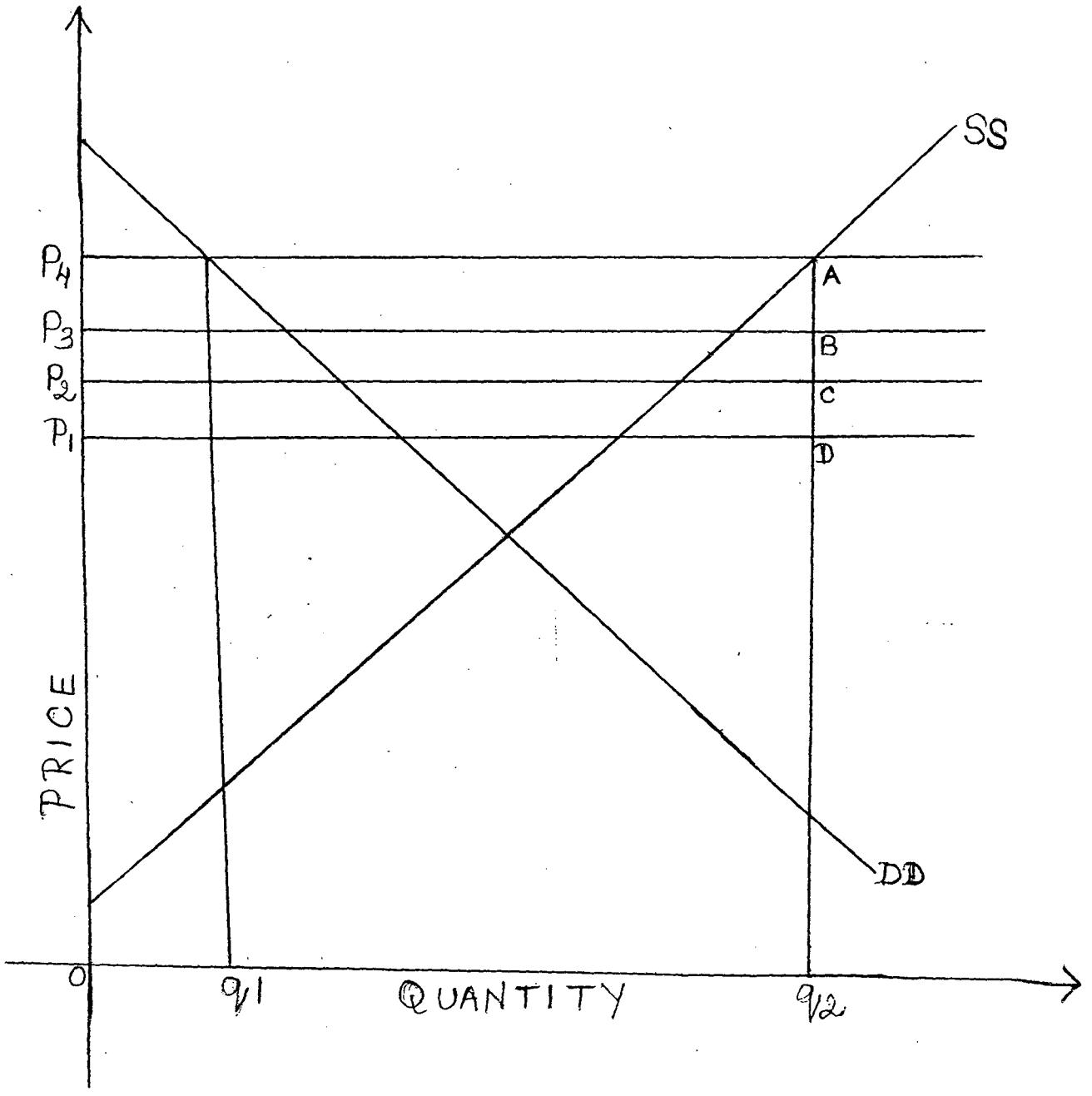
The following mechanisms were devised to achieve the goals of CAP:

(A) The country specific system of protection was replaced by a system of community wide uniform agricultural markets. This would result in ironing out regional inequalities too.

(B) Since for CAP, the interests of the European farmers being most important and import prices being lower than the EU prices, an import levy was imposed on these products to bring them on par or even higher than European union prices.

(C) They also envisaged financial solidarity among member states. The cost burden of running the Common Market Organization was to be shared among member states.

THE WORKING OF CAP[26]



26 Ibid., p.153.

For explaining the mechanism of the working of CAP, we may take the commodity, wheat. A target price is set on a yearly basis to achieve the desired whole sale price in the city of Duisburg in Germany. Duisburg is faced with insufficient local supplies of wheat. Therefore the price here would be higher than the average EU price. In the diagram, it is given as OP_4. The threshold cost is calculated by allowing for transport and distribution cost from the port of Rotterdam. This is shown in the figure as OP_3. To ensure that imported wheat does not enter the common market at less than the threshold price, a variable import levy is imposed. This is equal to BD, i.e., the difference between World Market Price and Threshold price (OP_3-OP_1). A high target price would result in an excess production of Oq_2-Oq_1 = q_1q_1. To keep market price close to Target price, the authorities must remove excess supplies from the market. This is achieved by setting an intervention price which is 10 per cent to 15 per cent below target price.[27] It is given by OP_2. If price falls to OP_2, the authorities will enter the market to buy wheat to support the price. If the target price, supported by the import levy is consistently above equilibrium price, the authorities will have to buy wheat regularly to support the market price. This is the origin of large stock of food stuff under CAP. Thus it becomes amply clear that the CAP's intervention price mechanism hindered the free entry and sale of foreign agricultural products in the European market.

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27 Ibid., p.133.

CAP, GATT AND THE URUGUAY ROUND

The Uruguay Round of Trade negotiations brought the CAP into sharp focus. Agriculture was on the top of the Uruguay Round Negotiations and it posed a challenge to CAP.[28] From 1986, USA and the Cairns group[29] of agricultural exporters sought to bring about changes in the international level of agricultural support. Attention was placed on the high level of subsidies given to European farmers through CAP. It was argued that subsidies led to high prices which in turn led to expansion of agricultural This has transformed Western Europe from a major importer of agricultural products to a major exporter of the same. Major objections were raised under Article XVI, para 3 of GATT which clearly stated that,

> ...contracting parties should seek to avoid the use of subsidies on export of primary products. If however, a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product.[30]

Opprobrium had been directed against the EC system of export refunds for agricultural exporters which ensured competitiveness of high priced agricultural products. At the beginning of Uruguay Round, USA and the Cairns group demanded

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28 Ibid., p.136.

29 Cairns Group consists of 8 agricultural export oriented economies which have joined together since 1986 to present common positions on GATT farm talks. They are: Australia, Argentina, Brazil, Canada, Chile, Columbia, Fiji, Hungary, Indonesia, Malaysia, New Zealand, Philippines, Thailand, Uruguay.

30 GATT, *Basic Instruments and Selected Documents*, Geneva, vol.IV, March 1969, p.17.

the Zero Duty Option, i.e., the abolition of all supports within ten years, and the introduction of international free trade in agricultural products.[31] It was then revised to 90 per cent cuts in export subsidies and 75 per cent cuts in other supports., At the Houston Summit in July 1990, the EC proposed the freezing of all Aggregate Minimum Support at Current Levels and an annual trimming back by an agreed percentage. After several attempts to find a solution, an offer was made at the GATT meeting in Brussels in October 1990 for a cut of 30 per cent of subsidies, backdating to 1986. This was equivalent to a reduction in support for farmers by 15 per cent from 1991 to 1995.[32] The French farmers on the one hand demanded safeguards like prevention of dumping of cereal substitutes on the EC market while the Germans demanded the provision of direct income aid to rural dwellers.[33] The Community as a whole advocated retaining some of the subsidies highlighting the following factors:

(a) . the need for self-sufficiency and national security; and

(b) the need for preventing price instability for products.

After a series of long-winding and tedious round of negotiations, the Blair House Accord was reached on agriculture by which:

(a) it was agreed to reduce domestic agricultural subsidies by 20 per cent over a 6 year period with 1986-88 as the base;

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31 John Gibbons, n.24, p.137.

32 Ibid., p.137.

33 Ibid.

(b) export subsidies would be reduced by 21 per cent in terms of volume of agricultural products and 36 per cent in terms of cash prices;

(c) there would be an overall tariff reduction in agriculture to the tune of 36 per cent over a 6 year period, with a minimum of 15 per cent in each product.

(d) All existing import quotas are to be changed into tariffs.[34]

Thus it is hoped that through the changes agreed to by the European Union in the Uruguay Round and after, there would be a change in Europe's agricultural regime, from a closed agricultural regime to an open one. It should however be noted that a series of changes have already been initiated by the Macsherry Reform in the direction of bringing European agricultural protection structure on par with GATT/WTO consistent norms. The opening up of European agricultural markets will go a long way in absorbing the agricultural production from developing countries and thus raising the standard of living of these countries.

SECTION B

The most important case involving a trade dispute, which has occupied the minds of trade law experts has been the European Commission's Hormone Case (1998). In this case two panels had dealt with two sets of complaints filed by the US and Canada against the European Communities (EC) concerning prohibition of imports of meat and meat products derived from cattle to which either the natural hormones: Oestradiol-17B, progesterone or synthetic hormones: Trenbalone acetate,

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34 M.J. Trebilcock, and Robert House, *The Regulation of International Trade* (London: Routledge, 1995), p.210.

zeranole or Melengestrol Acetate (MGA), had been administered for growth promotion purposes.[35] The respective panels had circulated their reports to the members of WTO in August 1997. It was argued that these hormones, if not properly administered, could cause serious health hazards to humans.

The Panel Report

Both the panels reached the same conclusions.[36]

(a) The EC by maintaining sanitary measures which were not based on a risk assessment had acted inconsistently with the requirement contained in Art.5.1 of *Sanitary Phytosanitary Agreement* (SPS), which states "members shall ensure that their sanitary or phytosanitary measures are based on an assessment as appropriate to the circumstances, of the risk of human, animal, plantlife or health, taking into account risk assessment techniques developed by relevant international organizations".[37]

(b) The EC adopted arbitrary or unjustifiable distinctions in levels of sanitary protection it considered to be appropriate in different situations which resulted in discrimination or disguised restriction on international trade. Thus EC had acted in violation of the requirements contained in Art.5.5 of SPS Agreement which states "With the objective of achieving consistency in the application of the concept of appropriate level of sanitary or phytosanitary protection against risk to human life or health or to animal or plant life or health, each member shall avoid arbitrary or unjustifiable distinctions in the level it considers to be appropriate in different situations, if such

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35 For a detailed discussion of the dispute see H. Hammonds, "A U.S. Perspective on the EEC Hormone Directive", *Michigan Journal of International Law*, vol.11 (1990), pp.840-44.

36 B.S. Chimni, *WTO Dispute Settlement System and Sustainable Development* (New Delhi: World Wide Fund for Nature, May 1999), p.71.

37 Trade Negotiations Committee of the Multilateral Trade Negotiations of The Uruguay Round, "Final Act Embodying the Results of The Uruguay Round of Multilateral Trade Negotiations", Marrakesh, 15 April 1994, p.72.

discrimination results in discrimination or a disguised restriction on international trade".[38]

(c) The EC by maintaining sanitary measures which are not based on existing International Standards without justification under Art.3.3 of SPS Agreement, had acted in violation of Art.3.1. Art.3.1 of SPS Agreement states, "To harmonise sanitary and phytosanitary measures on as wide a basis as possible, members shall base their sanitary or phytosanitary measures on international standards, guidelines or recommendations, where they exist, except as otherwise provided in this agreement and in particular in paragraph 3" (i.e., 3.3)".[39] Art.3.3 of SPS states, "Members may introduce or maintain sanitary or phytosanitary measures which result in a higher level of sanitary or phytosanitary protection than would be achieved by measures based on the relevant international standards, guidelines or recommendations, if there is a scientific justification or as a consequence of the level of sanitary or phytosanitary protection a member determines to be appropriate in accordance with the relevant provisions of paragraphs 1 to 8 of Article 5".[40]

It must be noted that the series of arguments advanced by Canada and USA were based on the contention that the EU while imposing a ban on the beef from the two countries on the ground that the growth hormones which were administered were likely to cause cancer, had failed to undertake foolproof risk-assessment tests.

The Appellate body on 5th January 1998, gave its report which contained the following points:

(a) It upheld the panel conclusion that the precautionary principle would not override the explicit wording of Art.5.1 and Art.5.2 and that the precautionary principle has already been given in Art.5.7 of the SPS agreement. The precautionary principle given in Art.5.7 states, "In

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38 Ibid.

39 Trade Negotiations Committee of the Multilateral Trade Negotiations of the Uruguay Round, n.37, pp.70-71.

40 Ibid.

cases where relevant scientific evidence is insufficient, a member may provisionally adopt sanitary or phytosanitary measures on the basis of available pertinent information, including that from relevant international organizations as well as from sanitary and phytosanitary measures applied by other members. In such circumstances, members shall seek to obtain the additional information necessary for a more objective assessment of risk and sanitary or phytosanitary measure accordingly within a reasonable period of time".[41]

(b) It upheld the panel finding that a measure to be consistent with the requirements of Art.3.3, must comply inter alia with the requirements contained in Article 5 of the SPS Agreement.

(c) It modified the Panel interpretation of risk assessment by holding that neither Article 5.1 nor Art.5.2 of SPS agreement requires a risk assessment to establish a minimum quantifiable magnitude of risk nor to these provisions exclude a priori, from the scope for risk assessment, factors which are not susceptible of quantitative analysis by empirical or experimental laboratory methods commonly associated with physical sciences.

While noting that the right of members to establish their own level of sanitary protection was an autonomous right under Article 3.3 of SPS agreement, the right of a member to define its appropriate level of protection was not an absolute or unquantified right. The states were bound to act in compliance with the requirements as given under Article 5.1, which was intended as a countervailing factor in respect of the right of members to establish an appropriate level of protection.

Though the Appellate Body supported EU's arguments regarding the interpretation of many of the legal issues involved in the case, it too was forced to conclude that the EC measures at issue were inconsistent with the requirements of Article 5.1 of SPS agreement. But it modified the panel interpretation by holding that

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41 Ibid., p.72.

Article 5.1 read in conjunction with Article 2.2 requires that risk assessment must sufficiently warrant the SPS measure at stake.

SECTION C

OTHER LESS COMMONLY NOTICED PROTECTIONIST MEASURES

a) New Aircraft Certification:

The United States is concerned about the possibility of European Aircraft Certification standards being applied so as to impede delivery of qualified aircraft into Europe. Processes and procedures adopted by European Joint Aviation Authorities [JAA] are cumbersome and arbitrary. For eg. France insists on an exception to JAA's decision on certification of Boeings new model 737 aircraft that limits the density of aircrafts sold to carriers located in France.[42] The JAA's decision took inordinately long time, during which additional conditions were imposed on US companies.

b) Discrimination in the Utilities Sector:

In 1990, in an effort to open government procurement markets within the EU, the EU adopted a Utilities Directive covering purchases in water transportation, energy and telecommunication sectors. The directive requires open, objective bidding

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42 http//www.useu.be/ISSUES/trade46.html, p.12.

procedures, but discriminates against non-EU bids which do not have the backing of a bilateral agreement.[43]

c) Subsidies:

i) Processed cheese subsidies:

On 1 October 1997, USA invoked the WTO Dispute Settlement procedure in the context of a section 301 investigation against European cheese.[44] EU produces cheese from diary components such as non-fat dry milk and butter. The processor receives subsidy upon the excess cheese produced. This acts as a disadvantage to foreign producers.

ii) Government Support for Airbus:

Since the inception of the European Airbus Consortium in 1967, its partner governments have given the company massive support by aiding the development, production and marketing of large civil aircrafts. In 1998, U.K. announced a loan of $212 million towards design and development of new wings for the aircraft A-340-500/600. In 1999, the French parliament budgeted $115 million for the same project. Moreover partner governments cover 75-100% of development costs of the industry

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43 Ibid.

44 Ibid., p.16.

in all lines of activity.[45] All these subsidies go a long way in providing the Consortium unfair advantage over its rivals.

iii) **Government Support to Shipping Industry**:

EU governments subsidies their shipping industry in a variety of ways. These include subsidised restructuring of domestic ship-building industry, subsidies for operations and investments, indirect subsidies, home credit schemes etc. All these forms of subsidies provide undue advantage to EU's Shipping Industry.

d) *SERVICE BARRIERS*

i) **Broadcast Directive and Motion Picture Quotas**:

In 1989, the EU issued the Broadcast Directive which included a provision requiring that a majority of entertainment broadcast transmission time be reserved for European Origin programmes. By the end of 1993, all EU member states of the EU had enacted legislations implementing the broadcast directive.[46] This is a major hindrance to the export of Motion pictures into EU.

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45 Ibid., p.17.

46 Ibid., p.24.

ii) **Airport Ground Handling:**

According to the present European rules, European air companies and ground handling service providers can apply for exemptions for the monopoly supply of provisions like ramp, fuel, baggage and mail at European airports. This effectively bars foreign service providers from providing the same.

iii) **Postal Services**:

The existence of postal monopolies in the EU restricts the market access of third country competitor and subjects them to unequal competitive conditions.[47] In fact USA has accused German Post of predatory pricing, abuse of dominant position, state aid, unfair cross subsidisation etc.

Telecom Market Access

Most EU member states discriminate against non-EU bids in telecom sector. Access to foreign sellers is restricted through standards, standard-setting procedures, testing, certification and inter-connection policies. For eg., European Parliament passed a resolution calling for the coordinated introduction of third generation mobile and wireless communication system called Universal Mobile Telecommunications System (UMTS).[48] It also calls for a harmonised system of granting licences. Here

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47 Ibid., p.27.

48 Ibid., p.28.

the effort is clearly to give preference to a particular European -developed standard to the exclusion of other standards. This will hamper trade prospects of third country sellers.

Electronic Commerce

As in the year 2000, the global internet trade is worth $300 billion.[49] A draft proposal before the WTO states that internet services should not be taxed. But in June 19998, the EC adopted the position that the existing Value Added Taxes (VAT) should be adopted to electronic commerce. It also suggested that electronic commerce should be considered as the provision of a service. The EU's Sixth VAT Directive enables member states to levy a Value Added Tax on off-shore suppliers of telecommunication and on-line services. The suppliers of these services would become liable for VAT on the basis of where their services are consumed against the standard practice applicable to European service suppliers of levying VAT on the basis of where the service was supplied or the corporation established.

EU's Trade Related Intellectual Property Restrictions

In 1984, EU created wheat is called the New Trade Policy instrument. The instrument allows the union to engage in trade retaliation against illicit commercial practices of non-union countries that affect Union's interests. "Illicit Commercial practices" are defined as violations of International Law or generally accepted rules.[50] According to the European Commission 'Green Paper' on Copyrights in

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49 Ibid.

50 Trebilcock and House, n.34, p.261.

the field of intellectual property rights, the instrument could play a greater role in future, particularly as regards countries which practice a policy of more or less active connivance in the pirating of goods and services developed elsewhere. This could be used extensively against countries violating the Paris and Berne Conventions in the case of intellectual property rights.[51] This paves way for wide discrimination against those Third World countries which lack the monetary prowess to make available cutting edge literature to its masses at affordable prices. Many of the new books would be placed out of reach of the university system as well.

Conclusions

Though the above mentioned measures have been instituted in the name of denying any unfair trading advantage to a trading partner, their effects have often been to restrict competition itself. The measures initiated against the "unfair trade practices" have been seen to go against a basic axiom in business -- price according to what the market can bear, especially in cases in which measures have been initiated even when pricing was not below cost.

Nor surprisingly, in most developed countries, anti-dumping and other trade measures are initiated by pressures from cartel-like industry associations. The European Union has devised a scheme of simultaneous proceeding against trade offenders, in order to pin down threatening competitors. For example, the DG-IV[52] of the European Commission has often adopted a delinked approach on

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51 Ibid.

52 DG is the shortform for Directorate General.

investigating complaints. Thus in the EU, one can have an anti-dumping investigation being conducted by DG-I, simultaneously with investigations into unfair trade practices undertaken by DG-IV.[53] DG-I need not and often does not wait for DG-IV to conclude its investigations, before imposing a provisional or definitive anti-dumping duty. Often competition itself is the victim, smothered by cartels in the domestic market.

The sole concern of the Commission with regard to trade seems to be community interest and nothing else. This is seen in the way an interest test is also administered on various anti-dumping measures. The interest test looks into whether the trade remedy in question is in the interest of the entire community or not, both from the view of the producers as well as from that of the consumers. While these margins are only supposed to eliminate unfair under pricing, the complicated rules applied in most EU countries produce much higher penalty rates -- not, infrequently 50 per cent of more of the product's landed value. Thus, it seems that only the community interest and not the interest of the competitor forms part of the calculations of the Union's trade policies.

In recent years, the discriminatory competition policy of the European Union has become an instrument of corruption in the hands of major European Companies. In this regard, a notable case was that of Pechiney, a French Company. Pechiney is a monopoly producer of pure calcium metal in EU. When it refused to supply to

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53 Powell, Goldstein, Fraser, and Murphy, "Background Paper", Conference on Anti-Dumping (New Delhi: Hammond Suddards & CII, 13 February 1999), p.5.

Extramet, the buyer then purchased the metal from Soviet and Chinese sources. Pechiney, lodged an anti-dumping Complaint against the Soviet and Chinese suppliers, via the "Chambre Syndicale de l'Elocrometalliergie et de l'Electrochemie". On 21 September 1989, definitive anti-dumping duties were imposed i.e., a 21.8 per cent duty on the Soviet metal and another 22 per cent duty on the Chinese metal. The grounds of imposition of the duties were so untenable that the European Court at Luxembourg on 11 June 1992 had to strike the anti-dumping duty down.[54] Its verdict, for the first time inducted a bit of fairness in European Law by stating thus, "[The Court] considers that, in anti-dumping proceedings, account must be taken of such anti-competitive practices, and that an anti-dumping duty must not be imposed if its effect would be to maintain an unjustified advantage in the Community market resulting from a cartel or an abuse of a dominant position, provided that formal evidence is produced and an action is brought on the basis of Community Competition Law".[55]

Thus, we can conclude by noting that protectionism is a live issue hindering better commercial relations between the EU and the rest of the world. It is quite evident that European law discriminates against foreign products, giving a distinct advantage to European products.

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54 Ibid., pp.3-5.

55 Ibid., p.6.

Chapter 4

TRADE PROTECTION THROUGH ENVIRONMENT RELATED MEASURES

Free trade and protection of the environment share an uneasy relationship. Resolving the tension between rules on free-trade and national environment is becoming a major task for both the GATT and the European Community. Often it has come to be noticed that the trade related environment measures of the Commission has worked against the interests of its trading partners, especially the Third World countries. In the term 'Trade-Related Environmental Measures' (TREMs) include those measures whose primary justification is the protection of the environment, but which take the form of trade instruments.[1] TREMS were used for a wide range of reasons:

(a) to discourage unsustainable exploitation of natural resources,

(b) to discourage environmentally harmful production processes

(c) to induce producers to internalise the costs of environmental harms associated with products and production processes,

(d) to prevent states not implementing a given policy from gaining a competitive advantage by avoiding costly environmental investments or expenses,

(e) to prevent the migration of industries especially affected by a policy from migrating to states not implementing the policies (called "pollution havens").

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1 Kenneth P. Ewing and Richard G. Tarasofsky, *The Trade and Environment Agenda: Survey of Major Issues and Proposals* (Siegburg: International Council for Environment Law and International Union for Conservation of Nature and Natural Resources, 1997), p.5.

For a proper understanding of the discriminatory nature of the community provisions, it is necessary to see first what the GATT/WTO provisions regarding environment are.

GATT and its Chapter on Environment

Many of the border measures connected with environmental goals are on their face violation of Article XI of GATT, which states:

> No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party".[2]

But GATT protects many of the environmental measures, by virtue of the exceptions given under Article XX, provided "such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where same conditions prevail or a disguised restriction on International trade".[3] The exception given under Article XX(b) relating to environment is an authorization to take measures necessary to protect human, animal or plant life or health. Further Article XX(g), authorises member nations to take steps relating to the conservation of exhaustible resources if such measures are made effective in conjunction with restrictions on domestic production and consumption.

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2 GATT, *Basic Instruments and Selected Documents*, (Geneva, GATT, 1969), p.17.

3 Ibid., p.37.

The word environment is not mentioned explicitly in either of the passages. This has led commentators like Shrybman to argue that these were intended to cover a narrower range of concerns.[4] They could have been included for narrow commercial concerns, like for e.g., the economic consequences of crop pestilences, etc., or for other health reasons like protecting humans from eating contaminated meat etc. But writers like Charnovitz on the other hand argue that the framers were aware of the current conservation goals of their times and hence the inclusion of the provisions.

Though the GATT language seemed to indicate that the imposition of measures under Art.XX for protection to domestic industry can be easily traced, in practice it has not been so easy. Keeping these aspects in mind the "Agreement on Technical Barriers to Trade" was arrived at. First of all, in the agreement, the parties agreed to use accepted international standards rather than national ones Second, parties deviating from accepted international norms would be required to demonstrate that the resulting barriers did not constitute an unnecessary obstacle to trade. Most importantly, Members shall ensure that "technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective".[5] "Such legitimate objectives are *inter alia*, national security requirements, the prevention of deceptive practices; protection of human health or safety, animal or plant life or health or the

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4 As referred to in, M.J. Trebilcock, and R. House, *The Regulation of International Trade* (London: Routledge, 1995), p.334.

5 Trade Negotiations Committee of the Multilateral Trade Negotiations of the Uruguay Round, *Technical Barriers to Trade* (Marrakesh, GATT, 15 April 1994), p.118.

environment".[6] The explicit statement about environment has highlighted the importance of environment in recent times.

GATT AND TREMs

The WTO dispute settlement procedure can play an important role in defining and applying rights and responsibilities related to TREMs. Although not binding beyond a particular dispute, each dispute settlement report, even if unadopted, contributes to the body of influential interpretations that subsequent dispute resolution panels may turn for advice.

The analysis of whether TREMs violate GATT has to proceed at two levels.[7] First TREMs may conflict with some fundamental GATT obligation. For instance, a treaty allowing trade in certain products among its parties, but banning trade between parties and non-parties may be seen as violating the Most Favoured Nations Principle. Second, once a violation of a substantive GATT requirement has been found, the analysis shifts to GATT, Article XX, namely the General Exceptions. In the case of TREMs, the question becomes whether GATT Articles XX(b) or XX(g) can apply to save the otherwise GATT-incompatible measures. It is here that uncertainty arises.

Recently the panels have held that to be necessary to protect human, animal, plantlife or health as required for the exception under Article XX(b),[8] no alternative

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6 Ibid.

7 Ewing and Tara Sofsky, n.1, p.10.

8 GATT, n.2, p.17.

GATT-consistent measure must be available and the measure in question must restrict trade to the least possible extent. Further, GATT panels, considering the disputes arising as a result of U.S. restrictions on Mexican tuna concluded that:[9] (a) the GATT does not permit states to take measures affecting trade, if they distinguish among products based on their process or production methods [PPMs]; and (b) the GATT's general exceptions do not apply to measures intended to achieve their aims by inducing other states to change their policies.

The Appellate Body in the famous Gasoline Dispute stated that what mattered essentially was whether the whole challenged measure was aimed at conservation. But the panel in this case questioned whether the component which violated GATT was aimed at conservation.

Thus it is quite clear that the nature of interface between GATT and TREMs is a highly debated issue. Clarity of the questions involved would be attained only when decisions on more environment related issues are published.

Convention on International Trade in Endangered Species (CITES)

Faced with an alarming increase in the international trade in endangered species, states concluded, at Washington, the CITES. It is intended to prevent over-exploitation of endangered species through trade. Article III[10] of the Convention bans commercial trade in species most threatened with extinction and strictly regulates trade in those which may be faced with extinction in the near future. Trade in both

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9 Ewing, and Tarasofsky, n.1, p.9.

10 Ibid., p.10.

these categories require import and export permits. But the grey area of CITES which has been exploited by the advanced countries in recent times is Article XIV[11] which allows the states to impose stricter trade restrictions.

The Effects of Adoption of High Environmental Standards on Low Environmental Standard Producers (Here the Less Developed Countries [LDCs])

The effects of the imposition of high environmental standards of production on LDCs can be shown by the following diagram. Let us assume that country has high environmental standards. This imposes a higher cost on firms. Country B has low environmental standards, but driven by the need to export to A, which demands higher standards, it too is forced to accept those higher standards.

For Country B, 'D' is the domestic demand, PMC is the Private Marginal Cost in the production of product Q. SMC (B) and SMC(A) are defined as PMC+External Marginal Cost (the assumption being that only environmental costs are included), in Country B and A respectively. Assuming lax - environmental standards in Country B and the world market price Po prevails, it produces product Q at an output level q_1 and exports q_1-q_2 to Country A. Country B acquires competitive advantage by ignoring marginal environmental cost represented by shaded area, selling Q at less than the true cost of production.[12]

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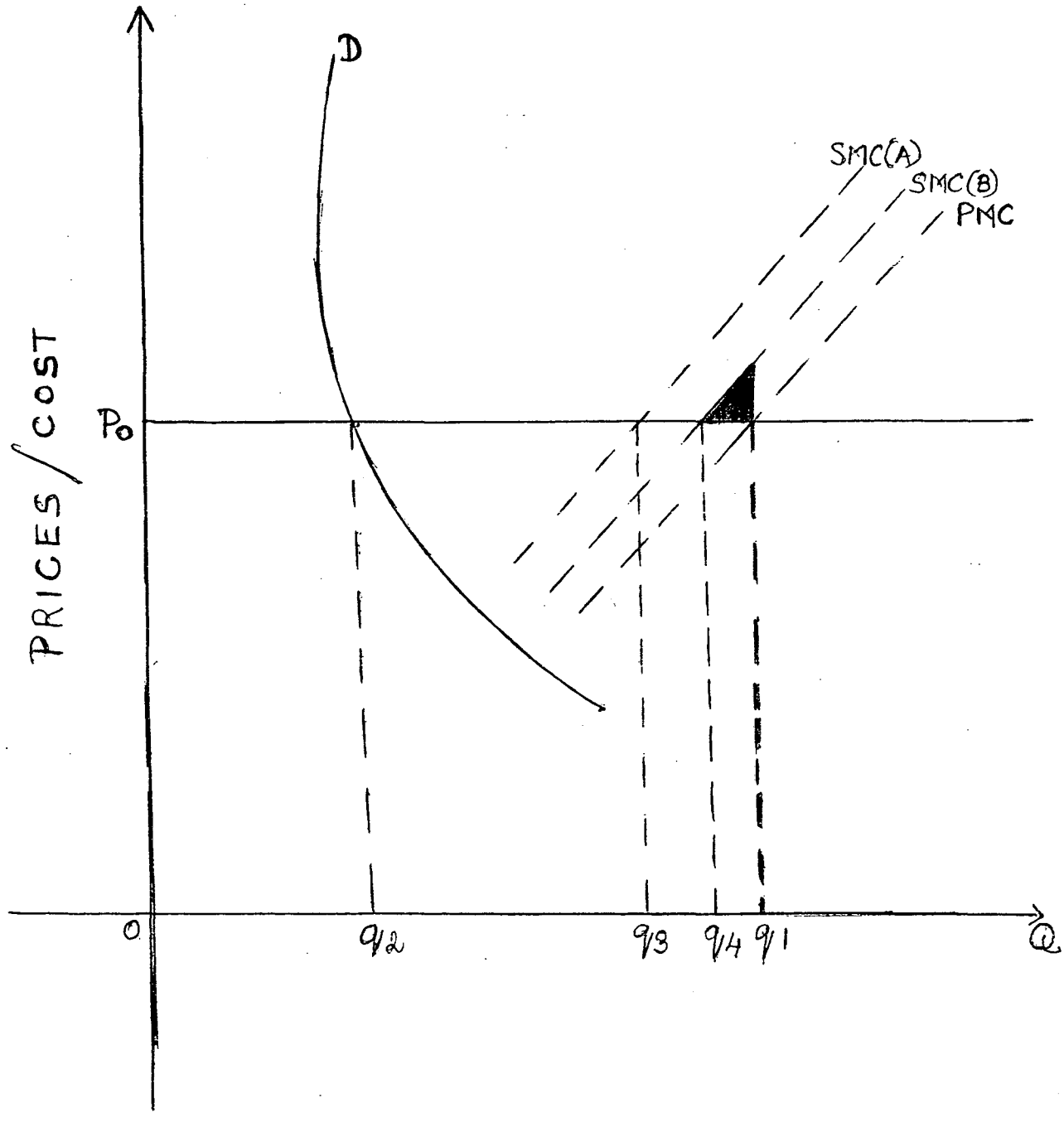
11 Ibid., p.10.

12 John Hassan, "Environment Policy" in Frank McDonald and Stephen Dearden, eds., *European Economic Integration* (London, Longman, 1992), p.121.

Figure 8: The Costs of Environmental Standards



This is a type of social dumping which results from country B's overproduction (because it takes no account of the environmental cost of producing Q).

When the high standards of Country A are adopted by Country B, it experiences losses. It is forced to produce at a non-optimal level q3, with their exports reduced to q3-q1. This is exactly the problem faced by less developed countries, which are forced to deal with the high standards prescribed by the EU.

The EU Environmental Regulations

The primary sources of EU law are laid down in the treaties by which EU has been founded. The secondary source of EU law is the legislative output of the institutions especially the European Council and the Commission. The Legislative output can take the form of Directives, Regulations and Decisions. The Regulations are binding entirely and directly on all states and parties in all their details. Directives are binding as to result on the named states, which choose the form of compliance. Decision or acts are binding in their entirety on parties, including states to which they are addressed.

The Commission is the executive arm of the EU. It employs 17,000 strong staff and is divided into 23 Directorate Generals (DGs).[13] DG-XI is responsible for environment.

As regards the primary EU laws regarding environment, they emphasise preventive action, the principle that the polluter pays and that environmental damage

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13 Komm a Consultants BV, "Sustainable Development", *Eco Trade Manual*, February 1996, p.20.

should be rectified at source. It also aims at introducing the precautionary principle. It also elaborates on the considerations during the preparatory stages of the union policy. It also contains provisions for co-operation with third countries and International Organizations. It also lays down procedures by which action is to be taken and the measures to be adopted. In addition, EU is a signatory to the 1974 Washington Convention on Trade In Endangered Species (CITES).

IEU's Fifth Action Programme on Environment[14]

This action programme is aimed at making EU action on Environment more proactive, embracing the theme of sustainable development given in the 1987 Brundtland Report on Environment. The framework for the action programme is given as follows:

FIFTH ACTION PROGRAMME

Legal Instruments	*Financial Instruments*	*Horizontal Support Mechanism*
- Regulations	- Eco Taxes	- European Environment Agency (EEA)
- Decisions	- Charges	- Various other institutions
- Recommendations	- Tradeable pollution permits	
- Opinions	- Subsidies	
- Directives	- Liability Regime	
	- Green Generalized system of Preferences	

Implementation by Member States
Two exceptions

- Temporary derogation of financial support to implement Measures
- Member states can impose stringent measures.

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14 Ibid., p.21.

AIMS

- Full implementation of "Polluter Pays Principle"
- Pollution Prevention at source
- Integration of Environment policy into other EU policy

THROUGH Co-OPERATION

- Between Government and Industry
- EU Industries among themselves
- Governments at EU level
- EU governments and Third Parties
- EU Industries and their counterparts in Third Countries

Consequences for Exporters in Developing Countries

Increasingly, manufacturers in the developing countries will be held responsible for falling foul of EU laws. This not only refers to the use phase of products but also to the product disposal stage. The increasingly stringent measures in terms of product composition would make it increasingly difficult for producers to evaluate their product composition. The manufacturers should also note that their success in the European market may be influenced by factors outside their control. E.g., specific financial charges that the union places upon products which it considers to be potentially hazardous for the environment. Information regarding the company's activities in general and the inclusion of risk phrases and product composition on packaging becomes a necessity, if the company is to retain credibility towards European authorities as well as towards the consumers.

II. Environmental Quality Standards[15]

The International Organization for Standardization published its 9000 series of Quality Management System. These standards define minimum requirements for the existence and management of business processes that guarantee a high level of product and service quality. The standards allow for 3 types of certification in contractual situations:

(a) ISO 9001 is the most comprehensive and assesses a company's ability to design manufacture, inspect and test its products;

(b) ISO 9002 assesses an organization's ability to manufacture and inspect and test quality products, but does not evaluate the design process;

(c) ISO 9003 assesses only the supplier's ability to inspect and test.

The ISO 9000 series of International Standards were accepted as European standards in December 1997. Though these standards covered the technical as well as commercial aspects of a product, a need was felt to evolve similar standards in the field of environment too. Much concern has also been raised regarding employees' health safety and quality of life. Standardization with regard to environment is driven by 2 forces.

(a) Companies just cannot expect that the general public is willing to buy products from an environmentally unsound producer.

(b) The differences in environmental standards within the different European Union due to differences in national legislation, is likely to lead to new International trade barriers.

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15 Ibid., p.60.

For effecting a common environmental standard, the European Union started implementing a voluntary environment Management System named *Ecological Management Audit Scheme (EMAS)*. The EMAS is similar in its content to the British standard scheme titled BS-7750.[16]

The EMAS and the British Standard Scheme titled BS-7750 have certain common features. Firstly, there has to be a company-wide commitment to achieve a continuously better environmental performance. This has to be binding on both the top-level management and the shop-floor employees. Secondly, the company has to draw up an environment policy establishing an overall sense of direction and setting the overall parameters for action. The policy determines the overall goals in terms of the level of environmental performance. Thirdly, it is of importance that all the staff are well-trained and up-to-date on new environment performance enhancing techniques. So training of workforce is also essential. Fourthly, the Company has to make a list of all potential environmental effects that the company's products and processes could have in their respective life cycles. Fifthly, the company has to prepare a manual listing the tasks, responsibilities, deadlines etc., for all the activities undertaken and those which would be undertaken in future. This will serve as a source for internal reviews also. Sixthly, the company has also to develop "what if" plans, procedures etc. Moreover, sufficient control over environmental management system has to be built in. Last, but not the least, to keep every one inside the organization on their toes (with regard to environmental goals), internal reports need

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16 Komma Consultants, B.V., n[illegible], p.65,.

to be circulated among all the employees. The report should cover aspects like success attained, future actions needed, procedures to be adopted etc.

Like BS7750, France has also drawn up standards for Environment Management, called X30-200. It does not cover company auditing of production sites.

More recently, in 1996, the European Union adopted the ISO-14000 series of Environment Management Standards covering a wide range of subjects such as Continual improvement in environmental performance for companies, compliance auditing, the environmental surroundings in which an organization operates, including flora, fauna, etc., interaction of the company's product with the environment, impact of the product on the environment, environmental management programmes of the company, its environmental management audit system, environmental objectives, environmental policy of the organization, environmental target, and so on.

Impact on Developing Countries

In their quest for more stringent and more effective environmental standards, the interest of the developing countries are being overlooked. The only hope is that the ISO will draw up a publication equal to ISO 9000 Development Manual to help companies in developing countries to implement basic Environment Management Systems. This can be done only if the companies of the European Union are ready to transfer appropriate technology for environmental management. Moreover ISO-14000 series is sought to be made universally applicable which compounds the problems of developing countries. Again it is important for exporters from

Developing countries to stay up-to-date with the issues concerning EMAS and ISO 14000, since EMAS registration is possible only on site by site basis in Europe. This would mean that a company can get EMAS registration only for its plants established in Europe. So the only viable alternative is for these companies to contact branch organization or standardization institution of the country to which they export, in order to receive information about the prevailing environmental standards.

III. *Environmental LABELLING*[17]

Environmental Labelling is concerned with applying environmental standards to pre-determined product categories. It does not only mean that producers show the products contents on the pack, eco-labelling goes to the very heart of production process, constantly researching whether or not the product can be produced in a more environmentally sound way. The competitive advantage that producers can currently gain by producing according to set environmental standards will in future erode as compliance, when ecolabel standards would be made a necessity.

The European Union, Environmental label scheme or Ecolabel scheme is based on the Council Regulation (EEC) No.880/92 of 23 March 1992. Except for food, drinks and pharmaceutical, no other product has been excluded from the scheme. The Award of labels is based on definition of relevant product groups and related Environmental criteria. Every EU member state is required to establish a competent body for the EU Ecolabel Award Scheme. Manufacturers including those

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17 Ibid., p.75.

in developing countries, or importers should make their application to the competent body in member states where the product was first marketed or manufactured. If one of these competent national bodies, wishes to approve an application, it must notify its intention to the European Commission. The Commission then notifies all other competent bodies. If no objection is raised within 30 days, the label will be awarded and the same may be used across Europe. Some of the major organizations for the development of Environmental product hallmarks are the Stichting Milieukeur (which issues the Milieukeur Label), SKAL (Inspective Organization for Organic Production Methods) instituted by German and Dutch governments (it issues the EKO label), the Blue Angel ('Blaue Engel') of Germany, the Nordic Ecolabel group (which issues the SWAN label), etc.

Consequences For Developing Countries

Manufacturers outside EU have strongly criticised ecolabel schemes because they claim that these operate as barriers to trade. They argue that these schemes intentionally or unintentionally reduce their market access chances. They are also concerned about the possibility of future marketing campaigns based on use of eco labels, Consumer boycotts of products that do not carry an ecolabel and incentive schemes such as requirement of ecolabelled products in public procurement contracts. They argue that setting up of these standards are too much influenced by domestic producer choices. The only alternative for this system is to develop broad principles for ecolabelling schemes within the framework of the International Organization for Standards (ISO).

Another major hurdle which Developing Countries would be facing in future would be the packaging regulations. Every exporter, exporting to Belgium, France and Germany has to take into account the packaging regulations in these countries. Separate regulations regarding waste collection have also been introduced. The only way to comply with these regulations is to contract an organization in the target country to take care of the collecting and processing of packaging waste. This can be a very costly affair.

IV. *Other Environment-Related Trade Measures affecti ng all Countries in General*

1. *Standardization:*

Standardization continues to be a major trade barrier against the trading partners of European Union. The US Department of Commerce anticipates that EU legislation covering regulated products will eventually cover 50% of US exports of EU.[18] Given the enormity of this trade, standardization initiated by the EU will be of considerable importance. The major concerns with regard to standardization are lags in drafting of harmonized legislation for regulated areas, inconsistent application and interpretation by member states of the rules, overlap among directives dealing with specific product areas and unclear labelling and marking requirements.

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18 http://www.useu.be/issues/trade46.html, p.6.

2. *Genetically Modified Organisms Product Approval (GMO)*:

Trade in Genetically Modified Organisms (GMOs) has been a major irritant in trading relations between EU and other advanced countries. Approval of viable GMOs including seeds and grains, for environmental release and commercialization is governed by directive 90/220; parliamentary debate on the issue may go on for years. Meanwhile many EU member states have suspended many GMOs without presenting any scientific justification. The Commission has been reluctant to prosecute these violations. Moreover, several products have been under review for 3 years as against an average 6 to 9 months process in Canada, Japan and USA. US approval of Corn exports to Spain and Portugal in 1997 were reduced to a fraction of historical levels due to tardy approvals.[19]

3. *Poultry Regulations*:

The EU continues to refuse anti-microbial treatment in poultry production. As a result US poultry exports to EU have been blocked since April 1977, representing a loss of $5 billion annually to US poultry exporters.[20] Moreover France opposes import of certain grades of poultry on the basis of feeding practices. All these are in effect Trade Discriminatory.

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19 Ibid., p.7.

20 Ibid., p.8.

4. *Specified Risk Materials Ban*:

On 30 July 1997, the EU adopted a ban on the use of Specified Risk Materials (SRMs), many of which it considered as environmentally harmful.[21] SRMs included (a) the skull, including of sheep and goats aged over 12 months, and (b) Spleen of sheep and goat. This measure was aimed to curb the spread of "madcow" disease. Industry source say that the ban would result in a total loss of $20 billion to exporters. The main problem with such a blanked ban is that it fails to account for regional disease differences in animal disease status and also does not take into consideration available scientific information and advice relating to the control of Bovine Spongiform Encephalopathy (BSE) and other Transmissible Spongiform Encephalopathies (TSE).

5. *Proposals on Aflatoxin Levels*:

In July 1998, the EU adopted a regulation harmonising maximum levels of Aflatoxins in peanuts, tree material, dried fruits, cereals and milk. A directive specifying sampling techniques to be used after 31 December 2000 were also specified.[22] Most countries regard these limits as too low in relation to consumer exposure and risk. These lead to trade protection without a corresponding increase in consumer safety.

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21 Ibid, p.10.

22 Ibid.

6. *Waste Management*:

The European Commission officials are working on draft proposals for a directive on batteries and a directive on Waste from Electrical and Electronic Equipment. The Draft directive aims to ban certain essential materials like lead, mercury and cadmium and mandates specific design standards. These lack adequate scientific and economic justification and may serve as unnecessary barriers to trade. Imposing the solo responsibility of collection and recycling of used products on the manufacturer is an unnecessary burden. The ban on Nickel Cadmium batteries is unworkable.[23]

7. *Triple Superphosphate*:

The EU imposes a 93% water solubility standard for fertilizer product triple superphosphate (TSP) to be marked as "EC Type Fertilizer".[24] TSP having lower percentage of water solubility can be sold in EU, but without the EC Type Fertilizer label. Scientific studies on the crops cultivated in EU have shown that water solubility rates of 90% or higher are not necessary to gain agronomic benefits associated with adding TSP to the soil. Substantially lower TSP rates would be adequate. The effect of such unjustified standards would be to restrict international trade in TSP.

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23 Ibid.

24 Ibid., p.13.

CONCLUSION

From the above analysis, it should be quite clear that the official machinery of the European Union is systematically engaged in a process whereby it seeks to entrench the creed of activist environmentalism both among the producers and consumers of the Union. At the same time, it has knowingly or unknowingly forced the producers in other countries, especially in the Third World, either to dramatically improve their standards (environmental) of production or to quit. Recent trends in the Union have also shown that the European Consumer also now favours more products which have been produced in an environmentally sound and human and animal friendly manner. The so-called Environmental Soundness currently provides manufacturers who are used to these high standards (mostly Europeans) with a marketing edge. But in future the attainment of these standards may become a basic requirement for exporting to the European Market.

Coupled with the problem of high standards, is also the problem of multiplicity of environment management systems which exist in Europe at present. There are divergent national, European and International Standards. This also creates barriers to an exporter, who has to keep in view his compliance with multiple standard requirements. All this, even after the repeated pledges towards the attainment of uniform standards among European member countries.

Thus it would suffice to say that, though higher environmental standards are desirable, the dogmatic adherence to these standards as is seen in the European Union, is a major hindrance to free and fair world trade.

Chapter 5

INDIA AND THE EUROPEAN UNION

India and the European Union members have enjoyed robust bilateral relations, even though in recent years occasional irritants in trade relations did surface to their mutual discomfiture. The relation between the two entities should be seen in terms of the prevailing international systemic arrangement. The functional arrangement of the world is evident from the existing all -encompassing capitalism which displays a large measure of cohesion and interdependence.[1] It is true that in certain cases, as in the UN General Assembly, countries of unequal power may conclude agreements on the basis of equality, yet one must admit that the International system is hierarchically organized in accordance with their political, economic, technological and cultural power. Power is implied as a state's capacity to exercise influence over other states. S. Sideri describes the international system as a pyramidical structure, as shown below.[2]

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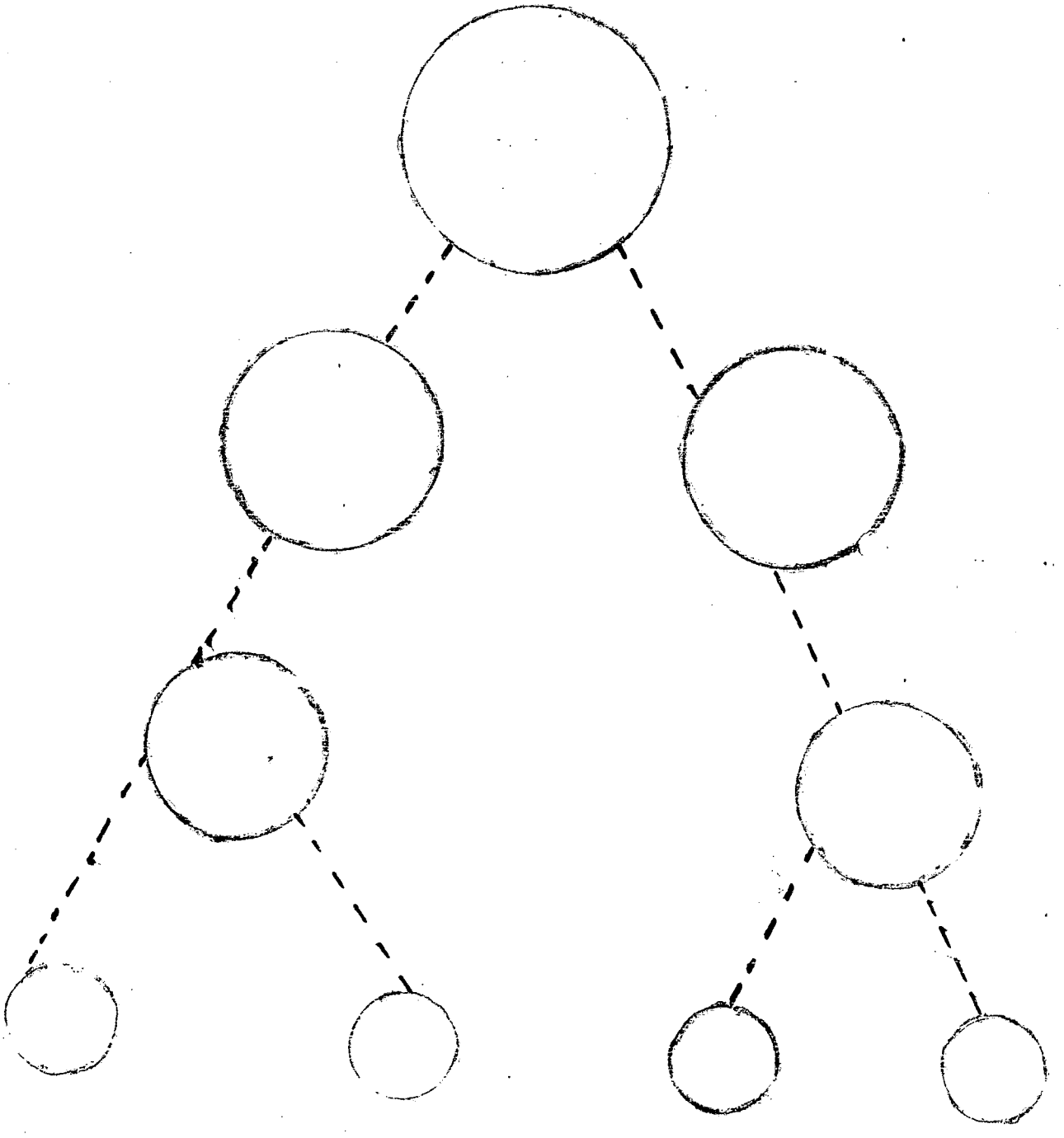
1 S. Saxena, "European Economic Community and India: Evaluation of the Concept of Interdependence", in H.S. Chopra, F. Ernst, and K.B. Lall, ed., *India and the EEC* (New Delhi: Allied Publishers, 1984), p.47.

2 Ibid., pp.47-49.

Figure 9: Depiction of the Pyramidical World Economic Structure



The direction of the arrows show that the lower regions are influenced by the decisions at the top. This implies that relations in the International system are asymmetrical.

Oliver C. Cox distinguishes between five ranks of nations: (a) leaders, (b) subsidiaries, (c) progressives, (d) dependent, (e) passive.[3] The first three ranks are occupied by USA (which is at the top) along with its other Western European allies. But in the group tilted dependents come countries of the third world, which possess political independence but are to a large measure under the sphere of influence of the great powers. The fifth group i.e., 'passive' is no more in existence; it referred to the one time colonies of great powers.

It would be clear from the trade data given in the following pages that India's exports to EU is a small portion of EU's total trade volume, whereas from India's point of view, EU accounts for a third of India's exports. So India has been dependent on the European markets (though in recent times there has been a shift for the better). This would indicate a kind of centre-periphery relation between the two entities. This kind of an outcome is basically the result of factors which have worked over time.[4]

(a) The heavily subsidised and protectionist agricultural policies which cut down markets for developing countries.

(b) Synthetic substitutes have cleared many natural products like jute and rubber from European Markets.

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3 Ibid., p.48.

4 Saxena, n.1, p.52.

(c) Mechanisation and automation which have increased industrial efficiency and thereby reduced the demand for raw-materials.

(d) Import tariffs and Quantitative Restrictions against developing countries.

THEORETICAL STUDY ABOUT EU-INDIA INTERDEPENDENCE

S.S. Saxena made a theoretical study of the Interdependence between EEC and India in a semi-notational form as follows. We can denote here by 'α', the internal aggregated self-interest of India. By 'β' we may imply, the internal aggregated self-interest of EEC.

Sl. No.	α (INDIA)	β (EEC)
1.	Access	Investment Guarantees
2.	Technical Knowhow	Reciprocity (in flow of purchasing power)
3.	Raw material processing (value added)	Supply guarantees

SITUATIONS

A Before the 15th century (i.e., before Vascodagama landed in India), $\alpha=0$, $\beta=0$. In this era, since India and the EEC were not interacting i.e., not known to each other α and β were 0. So the differential of α and β i.e., $a\alpha$ and $a\beta$ were also 0 (i.e., their sensitivity to change was also zero.

Therefore,

$$\blacktriangle = \frac{a\alpha}{a\beta} = 0;$$ Indicator of dominance

is also Nil.

(B) In the 17th and 18th centuries when, West Europeans gained foothold into major pockets in India. So,

$\alpha = 0$, whereas β (shoots up suddenly)

So, $a\alpha = 0$; but $a\beta$ = negative (β, being positive, European interests in Indian trade and wealth were so high that any deviation/sensitivity to change, forgoing this opportunity would harm them. So $a\beta$ = -).

Therefore,

$$\blacktriangle = \frac{a\alpha}{a\beta} = \frac{0 \text{ (finite positive)}}{\text{Negative}} = \text{Negative}$$

- Implying one way dominance/dependence.

(C) With British hegemony complete over India by the 19th Century,

α (just non-zero) = positive

β = very much positive

Here there is a qualitative difference between the two non-zero values of α & β. β is decidedly positive due to the exploitation of the colony and its raw-materials. For India too the situation is slightly advantageous, since a kind of positive externality from the manufacturing interest of the metropole sets in.

So $a\alpha$ = barely positive (nearly zero) and $a\beta$ = negative (same logic as for (B).

Therefore,

$$\blacktriangle = \frac{a\alpha}{a\beta} = \frac{+}{-} = \text{Negative} \rightarrow \text{One way dominance or dependence}$$

(D) At the time of India's independence

α (just non zero) = positive

β = positive with caution and care, since India could break away.

For the first time $a\alpha$ turns negative while $a\beta$ remains negative. It implies that India continued to need the advantages which were already on because of the Commonwealth and British legacy. Thus any drastic reversal of policy would have been counterproductive to India.

Therefore, $\blacktriangle = \frac{a\alpha}{a\beta} = \frac{\text{Negative}}{\text{Negative}} = \text{Positive.}$

a relation of Interdependence

(E) 1950s saw the introduction of foreign aid to the Third World. Thus α = positive, β = positive. In this period both the entities started looking for alternatives and so they were not extremely sensitive to deviations -- India, in this period looks for Import Substituting Industrialization through planning, while EEC is saddled with internal problems.

Therefore $a\alpha$ is positive and so is $a\beta$

$\blacktriangle = \frac{\text{Positive}}{\text{positive}}$ Positive → Interdependence

(F) Maturity in Indo-EEC Relations. Co-operative agreements start taking place. It was the time when other avenues -- markets, possibilities, regional combinations were seen as equally practicable with trade.

So, α = positive, though a declining trend in the sense that alternatives were available and therefore any deviation in the differential is seen as positive.

β = positive, though waning, in as much as other avenues were discovered.

By the same reasoning as in E, α = positive, β = positive and so,

$a\alpha$ = positive, $a\beta$ = positive

Then,

$$\blacktriangle = \frac{a\alpha}{a\beta} = \frac{\text{Positive}}{\text{Positive}} = \text{Positive} \rightarrow \text{Inter-dependence}$$

(G) In the 1970s, the debacle of the Bretton Woods institutions occurred along with the centralization of Organization of Petroleum Exporting Countries (OPEC), the energy crisis and the emergence of the New International Economic Order (NIEO). The NIEO demanded more than mere peripheral changes in the system. By this time, their relations were touching the hard core of reality of an interdependent world.

α = positive, β = positive

This phase is in fact the turning point of this relation. Though a and a are positive, the nature of α and β being of the hard core type taking the differentials would not be particularly rewarding without taking α (India) and β (EEC) values in the global sense.

Therefore, $\blacktriangle = \frac{a\alpha}{a\beta} = \frac{\text{Positive}}{\text{Positive}} = \text{Positive}$

(H) Saxsena's analysis ends with the 1980s. But if we add another phase, i.e., till the present, we can see that with the culmination of the Uruguay Round and with the signing of the WTO agreement, both India and EU have got closely integrated with the World Capitalist system and therefore the interdependence of the two has been heightened. So for the EU, India now is not only a major investment destination but also a major market while for India, the former is a source of new technology, market and above all Investments. So,

α = positive, β = positive, but with substantially changed values.

So, $a\alpha$ = positive, $a\beta$ = positive (i.e., with the availability of a range of options for the two sides)

$$\blacktriangle = \frac{a\alpha}{a\beta} = \frac{\text{Positive}}{\text{Positive}} = \text{positive.}$$

But the fact remains that India's dependence on EU is far greater than EU's dependence on India.

Importance of European Markets

According to a recent WTO report, West Europe accounts for 40 per cent of the global trade. The combined value of global trade in goods and services in 1996 was $6.3 trillion comprising US$5.1 trillion of goods and $1.2 trillion of services. U.S. is the leading exporter of goods at US$ 624.8 billion, followed by Germany with US$ 521.2 billion, Japan with US$412.6 billion, France, U.K. and Italy come next with $290.3 billion, $259.1 billion and $250.7 billion respectively.[6]

As regards India's exports to the EU, its exports were valued at Rs.36,826 crores in 1998-99, of which Belgium accounted for Rs.5,458 crores, France for Rs.3,544 crores, Germany for Rs.7,229 crores, Netherlands for Rs.3,285 crores and UK for Rs.8,028 crores. It must be noted that the value of India's exports was higher to EU, than to USA, to which its exports were valued at Rs.30,842 crores in 1998-99. As regards, India's imports from the European Union, its total imports from the

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6 Indian Embassy (Vienna), "Trade between India and European Union -- A Gateways Perspective", Vienna, December 1997, p.7.

European Union were valued at Rs.41,633 crores in 1998-99. Of this total, Belgium accounted for Rs.10,589 France accounted for Rs.3,056 crores, Germany for Rs.8,998 crores, Netherlands for Rs.1,966 crores and the U.K. for Rs.10,793 crores.[7]

PERCENTAGE OF INDIA'S EXPORTS TO MAJOR EU COUNTRIES			
Countries	1997	1998	1999
TOTAL EU	25.0%	25.2%	26.0%
BELGIUM	3.3%	3.5%	3.9%
FRANCE	2.2%	2.2%	2.5%
GERMANY	5.7%	5.5%	5.6%
NETHERLANDS	2.6%	2.3%	2.3%
U.K.	6.1%	6.1%	5.7%

Source: ECONOMIC SURVEY 1999-2000 [The Table does not indicate individual figures for smaller EU countries]

PERCENTAGE OF INDIA'S IMPORTS FROM MAJOR EUCs			
Countries	1997	1998	1999
Total EU	25.3%	24.5%	23.6%
Belgium	5.8%	6.4%	6.0%
France	2.0%	1.9%	1.7%
Germany	7.2%	6.1%	5.1%
Netherlands	1.3%	1.1%	1.1%
U.K.	5.5%	5.9%	6.1%

Note: All EU countries have not been mentioned

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7 Government of India, Ministry of Finance, *Economic Survey 1999-2000* (New Delhi), pp.S-91 and S-92.

MARKET SHARES OF SELECTED COUNTRIES WITH THE EU					
Countries	1991	1992	1993	1994	1995
USA	18.66	17.80	17.27	17.26	19.02
Japan	10.52	10.57	9.74	9.04	9.97
Switzerland	7.00	7.17	7.36	7.17	8.04
China	3.04	3.44	4.05	4.26	4.80
Taiwan	2.24	2.20	2.14	1.93	2.16
South Korea	1.59	1.52	1.59	1.61	2.00
Malaysia	0.89	1.01	1.28	1.39	1.68
Singapore	1.06	1.16	1.32	1.14	1.60
India	0.97	1.00	1.21	1.28	1.43
Hong Kong	1.30	1.21	1.33	1.22	1.31
Thailand	1.02	1.16	1.14	1.17	1.21
Indonesia	0.73	0.89	1.04	1.09	1.12

Note: All figures are in Percentages.

Source: Indian Embassy (Vienna), "Trade between India and European Union -- A Gateways Perspective", Vienna, December 1997, p.7.

The tables given above clearly indicate the importance which the EU holds for India; While India accounts for a mere 1.43% of EU market share (as in 1995), EU accounts for nearly 25% of India's exports. As regards the composition of India's exports in general, we find still a skewness towards agricultural and low technology exports. In India's overall trade, agriculture and allied commodities account for 18.4% (April-November 1999), ready made garments account for 12% gems and jewellery account for about 18.1%, while electronics goods account for only

1.5%.[8] In volume terms, Belgium, France, Germany, Netherlands and U.K. account for more than 92% of India's total exports to the EU.

MAJOR BOTTLENECK IN INDO-EU TRADE RELATIONS

In order to understand the complexity of problems facing India and the European Union, a sector wise study of irritants should be undertaken.

(A) *Steel Industry*

India is the 9th largest producer of steel with a capacity of 33 million tones and another 12 million tonnes in the pipeline. It has an excess capacity of 32% and employs nearly 5 million people.[9] This industry is facing a serious threat of being swamped by a flood of cheap and defective items from the Developed Nations once Quantitative Restrictions are fully off. Its problem is compounded by the fact that protectionist trade blocks like EU are circumscribing opportunities. Indian exporters face severe anti-dumping duties in the EU along with a spate of Anti-subsidy cases which are being levelled against it. In this regard the major obstacle faced by this industry is that, very often data needed for disproving dumping charges are not easy to get. Moreover investigation procedure in the EU is very cumbersome and expensive.

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8 Ministry of Finance, n.7, p.S-90.

9 Latha, Anup Jayaram and Sandeep Joseph, "The World Is Here", *Business World* (Mumbai), 29 November 1999, p.26.

(B) *Chemicals and Petrochemicals*

The Chemical industry accounts for 15 per cent of India's manufacturing[10] and 13% of India's exports.[11] Over 30% of new investments since 1990 have been in this sector. This industry is likely to be threatened more and more in future in its trade with the European Union because of the increasing use of environment as a trade barrier. Its major handicap is the existence of high incidence of peak tariff and the deceptive average tariffs on items like polymers in developed countries including the EU. Commodity bias makes this industry susceptible to anti-dumping, anti-subsidy and safeguard actions.

(C) *Drugs and Pharmaceutical*

India's share in the global $399 billion pharmaceutical industry is 1%. The domestic market is fragmented with over 20,000 players and none having a market share of more than 7%.[12] The major threat faced by this industry are the accelerated lifting of Quantitative Restrictions ahead of 2003 and the introduction of full fledged product patenting by 2005. Interim protection to foreign companies is bound to be given through Exclusive Marketing Rights (EMR) principle. European Union pharmaceutical companies will also be major beneficiaries in this process. In this regard, Indian companies face the process of initiating increased anti-dumping

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10 Ibid.

11 "The World is Here", n.9, p.24.

12 Ibid., pp.24-25.

and anti-subsidy investigations leading to expensive legal proceedings. This sector provides an excellent example of the Europeans trying to prize open Indian markets, in spite of having protected their markets for many past decades.

(D) *Textiles and Clothing*

Textiles account for 4 per cent of GDP and 14% of Industrial production. It is the largest net foreign exchange earner and brings in 35% of export earnings.[13] It is both self-reliant and competent in value chain. This industry faces unjustified non-tariff barriers and back to back anti-dumping action in the EU. It is also subject to transitional safeguard action under Agreement On Textile And Clothing (ATC). The major handicap faced by this industry in its quest for market access into the EU is that there cannot be full access to EU markets till AD 2005 because of backloading in ATC, particularly in garments and fabrics.

(E) *Information Technology*[14]

Global software market is worth $300 billion in which India's share is less than 1% (.72%). Of the 1.7 million professionals 15% are Indians, but there is not even a single Indian Company among the top 25 firms that account for 45% of the market.[15] Industrial development programmes in many European Countries including in U.K. act as strong trade barriers. Entry restrictions in developed world

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13 Ibid., p.24.

14 For a detailed discussion on Indian software, see, *The Hindu*, "Survey of Indian Industry" (Chennai, January 2000, pp.321-24.

15 "The World Is Here", n.9, p.24.

which have backdoor policies for local companies act as major hindrances. Here the politics of standards is in full view.

HIDDEN PROTECTION: THE CASE OF AGRICULTURE

Under the latest tariff structure developed exclusively for agriculture from GSP countries including India, it made a four-fold division of Agricultural products based on their sensitivity. They are: (a) Very sensitive -- 15% reduction on the Most Favoured Nation Rate (MFN). (b) Sensitive -- 30% reduction on MFN rate of duty; (c) Semi Sensitive -- 65% reduction on MFN rate of duty. (d) Non-Sensitive -- 100% reduction on MFN rate of duty.[16]

The case of items not covered under any of the above duties would be at the normal MFN rate as these may have been found to be extremely sensitive.Again it should be noted that the degree of sensitivity is decided on the basis of its perceived sensitivity to Community's industry.

Rules of Origin

The scheme is subject to the strict condition that the origin specifications of all products must comply with the definition of origin adopted in accordance with the procedure laid down in Art.249 of EC Regulation No.2913/92.[17] According to it,

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16 Mission of India to EU, *EU's Import Tariff Regime for Agriculture Applicable to India from 1.1.1998*, Brussels, December 1997, p.iii.

17 Ibid.

if two or more countries are involved in the production of a particular product, the country of final export to EU would be eligible for preferential treatment, if the process undertaken in that country is sufficient to confer origin to it. The product is considered to be sufficient if it has resulted in a system of tariff classification in the harmonised system of nomenclature between the imported product and the finished product. This in fact is a very rigid stipulation of the facts pertaining to rules of origin. A slight variation in interpretation could result in a denial of the preferential treatment and this could adversely affect the developing countries.

Special Safeguard Provisions and GSP Withdrawal Situations

The EU has, under the 'Special Safeguard Provisions', retained the option of imposing additional duties in situations of excess imports or particularly low import prices during the reference period of 1986-88.[18] The additional duty so imposed should not be more than one-third of the normal excise duties.

Preferential treatment is liable to be withdrawn in whole or part if:

(a) there is evidence of practice of any form of forced labour,

(b) the product was produced with prison labour

(c) there are manifest shortcomings in customs controls on the export or transit of drugs or failure to comply with international conventions on Money Laundering.

(d) there are manifest cases of unfair trading practices on the part of a beneficiary country, including discrimination against the EU and

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18 Mission of India to EU, n.16, p.v.

failure to comply with obligations under the Uruguay Round to meet agreed market success objectives,

(e) there are manifest cases of infringement of objectives of International Conventions, concerning the conservation and management of fishery resources.

It would thus become clear that even in the case of the 'so called' preferential treatment clauses, access to European markets can be severely restricted by the use of various qualifying clauses. Though these may not be termed as protection or barrier to trade, in the conventional sense of the term, they do effectively prevent developing countries from acquiring a fair share of the European markets.

Graduation Principle

Under the scheme, some of the beneficiaries would gradually see the exclusion of major production sectors as soon as their exports of products covered by a scheme in a given sector having exceeded 25% of the beneficiary country's exports to EU in that sector. This is termed as the Graduation of a particular sector of a particular country. This, however would not apply to a country whose exports of a product in a given sector, do not exceed 2% of the beneficiary country's export to the EU. This again is a technique through which prominent exporters of a particular product are sought to be kept out.

India, is an agriculture based economy. Agriculture accounts for 29% of India's gross domestic product (GDP), 65% of the work force and 18%, of its global export basket. It accounts for 11.5% of India's exports to the EU. In 1996, out of a

total of ECU 7.9 billion worth of exports to the EU, agricultural exports accounted for ECU 1.1 billion.[19]

Exports to EU	1995		1996		India's Growth
	Extra EU	India (%)	Extra EU	India (%)	
Total Exports	544.4	7.8	579.5	7.9	1.3%
Total Agro Exports	52.9	0.89	55.7	1.15	29.4%
Marine Products	6.01	0.21	6.2	0.17	-20.8%
Other Agricultural Items	46.9	0.68	49.5	0.98	44.1%

It must be noted that while EU's import of agricultural products grew by 5.3%, India's exports have grown by 29%. This is on account of excellent performance in the other agricultural exports. Moreover, it should be noted that India's export to EU grew from ECU 643 million in 1992 to ECU 1153 million in 1996, i.e., a growth of 79.3% in 5 years. Consequently our market share has increased from 1.41% to 2.07% in the same period.[20] This kind of growth itself raises fears that in future, many of the instruments mentioned above may be increasingly used against India.

The main items of exports from India are seeds and flowers, fresh and processed fruits and vegetables, tea and coffee, basmati rice and other cereal preparation, gur gum, walnuts, mushrooms, papads, pickles, shrimp and prawns,

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19 Mission of India to EU, n16, p.vii.

20 Ibid.

squids and cuttlefish, tobacco and castoroil. Of them marine products, tea, coffee, tobacco, seeds, cereals, oil and fodder constitute 75% of India's exports. And a number of products include an additional component of import duty. They are: (a) the agricultural component reflected in the form of customs duty, (b) additional duty on flour in the case of cereal based products, and (c) additional duty on sugar in the case of sugar based products. These duties make it extremely difficult for Indian producers to compete in the European markets.

INDIA AND EU IN THE WTO

India's relation with the EU in recent times has been guided by the WTO and its institutions.

(a) *What has the Emergence of WTO meant for India and the EU?*

(i) *Liberalization of Trade Regime*[21]

Even though the GATT also dealt with the liberalization of trade regime the ambit of WTO is more comprehensive and rigorous. For e.g., GATT did not cover Non-Tariff Barriers. (NTB). WTO regime covers NTBs also. WTO is also endowed with enforcement authority and conducts policy reviews of member countries, unlike the GATT.

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21 Nagesh Kumar, "Emerging WTO Issues and Challenges: Imperatives for South Asia", in *South Asia Economic Journal* (New Delhi), vol.1, no.1, [redacted] 2000 pp.1-18.

(ii) *Industrial Production and Investment*

The patterns of Industrial investments and production will be affected by provisions of some of the agreements such as Trade Related Investment Measures (TRIMs) which limit the freedom of host country to impose Local Content Requirements on Multinational Corporations (MNCs).

(iii)*Agriculture Subsidies*

The WTO agreement on Agriculture for the first time regulates the quantum of subsidies that member governments give to agriculture. Earlier agricultural sector was largely subject to decision-making at the national level.

(iv) *Liberalization of Trade in Services*

The WTO regime covers a General Agreement on Trade in Services (GATS) while the GATT covered only industrial products. GATS provides a framework for liberalization in the service sector and is also complemented by agreements for different services such as Information Technology Agreement and Financial Services Agreement, that have been signed at the Singapore Ministerial Meeting of WTO.

(v) *Innovation and Technology Development*

The Trade Related Intellectual Property Rights Agreement (TRIPs) is going to affect innovation and Technology development in a significant way. The agreement

specifies higher norms of protection of intellectual property and recognition of product patents. This would adversely affect the process development activity in Chemical Industry in a number of developing countries. In India, process innovation activity has become a substantial part of the technological activity of firms.

(vi) *Public Finances*

WTO agreements affect the magnitude of government finances, i.e., by reducing the tariff, and public expenditure, i.e., by elementary subsidies. So the budgets and public finances of governments will have to be restructured accordingly.

(vii) *Prices*

Trade Liberalization as a part of implementation of WTO commitments will, in general, bring down prices. But prices of commodities like drugs are likely to increase in India due to the introduction of product patents.

(b) *Areas of Tussle between India and the EU in WTO trade Talks (present and future)*

Though the WTO ministerial level meeting which was convened in Seattle in November, 1999, ended in stalemate, the tussle of competing interests between the developed countries (like the European Union) and the developing countries (like India) are like to reemerge in future trade talks.

Joseph E. Stiglitz,[22] the Chief Economist of the World Bank has brought out the areas of concern for countries like India against entities like EU. He states quite clearly that developed countries exhibit hypocrisy in their policies with regard to sectors in which they have comparative disadvantage. In this case there is a strong exhibition of protectionism. No where is this hypocrisy more noticeable than in the case of Dumping and Countervailing duties. According to one calculation, if the standards used under dumping laws were applied domestically, 18 of the 20 top, Fortune 500 firms of USA could be accused of dumping.

Stiglitz has also raised the following points, which could be of interest to developing countries like India while bargaining with developed countries, especially with the EU at the WTO.

(a) *Sectoral Comprehensiveness*

India should in future, while dealing with EU, call for comprehensive sector-wise negotiations. Such negotiations provide more scope for designing policies that will compensate countries and potentially even groups within countries for losses in other areas. This can be done by including more areas under trade negotiations.

(b) *Liberalization of Goods to Liberalization of Services*

Liberalization of services should be of major interest to India. Indian economy is fast becoming a service oriented economy. It has great prospects for exporting its expertise in areas of Information Technology to the European countries. So it is

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22 Stiglitz, J., "Principles for the Next Round", *Business Today* (Mumbai), 7 November 1999, p.121.

expected that India would press for liberalization of the information services market of the European Union in future trade talks.

(c) *Comprehensiveness of Factors and Liberalization of Services*

Many developing countries are raising a key question about the scope of liberalization, i.e., why has there been so much of interest in the liberalization of movement of goods and capital and why has there been a lack of it with regard to movement of people, especially unskilled labour. If the EU is to be allowed to deliver effectively in services like insurance, India must be allowed to have some of its manpower in European countries.

(d) *New Trade Barriers*

Developed countries, including those of the EU have shown lot of creativity in creating barriers to trade, well beyond anti-dumping laws and their implementation. The most difficult to deal with are those which align protectionism with other interests. Some protectionists try to enlist environmental and labour groups to effect moral types of protectionist policies. Such unholy alliance of interest should be resisted. This also has to be India's focus in forthcoming WTO meets.

The major areas and patterns of discussion which would come up between India and the European Union in future trade talks are:

(i) *Agriculture*:

India's approach to the liberalization of agriculture is schizoid. It still does not know whether it will benefit or lose from agricultural liberalization. Ashok Gulati,

NABARD Professor, Institute of Economic Growth states that most Indian agro products are price competitive. They will be even more so, if as a result of agricultural liberalization, world prices rise. Agricultural subsidies and distortions are far more than the rest of the world in the European Union. The Uruguay Round has made some stipulations on agricultural subsidies and trade. Thus quantitative restrictions must be converted into tariffs, tariffs must be brought down, exports must be reduced and a certain part of agricultural products must be importable without licences. For domestic distortions, it prescribes a formula according to which distortions must be computed and expressed as a percentage of total value of agricultural output. This is known as Aggregate Measurement of Support (AMS). AMS will not be cut to 20%, but there will be a 20% cut on the base period AMS. Again, the AMS benchmark is 10% for developing countries. If it is more than 10%, it must be brought down by 13% within the next 10 years.[23]

The agreement on agriculture specifies two groups of measures -- Green Box Measures and Blue Box Measures. Inside the blue box measures are decoupled income support measures. These include government assistance on Research and extension, direct payment to producers in the form of income insurance and safety nets. Bluebox measures are a direct category of direct payments made for limiting production. India needs to talk to EU on these measure in the future rounds. Again tariff quotas continue to be extensively used and export subsidies have not been

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23 "Negotiating a New Beginning", *Business Today* (Mumbai), 22 November 1999, pp.54-55.

sufficiently reduced. Aggregate AMS reduction has been spliced with high subsidies at sector-specific levels.

There continues to be government trading monopolies in the agricultural sector. Non-Tariff Barriers have been surfacing through sanitary and phytosanitary measures. The Cairns group of agricultural producers are likely to aggressively set caps to AMS level in future and India should also support them on this.

(ii) *Textiles and Garments*:

The World Trade in textiles and garments was governed by a system of bilateral quotas under Multi-Fibre-Agreement (MFA). Under the Uruguay Round, these quotas will be phased out over a ten year period beginning 1 January 1995 and ending 1 January 2005. On 1 January 1995, 16% of the imports of textiles were to be outside quotas. On 1 January 1998, an additional 17% of the imports were to be outside quotas and 1 January 2001 another 18% were to be outside quotas and by 1 January 2005 the remaining 49% will be integrated and the MFA quota will end, although tariffs will continue.[24]

But it should be noted that even before the Uruguay Round, 30-35% of India's exports to EU were outside quotas. So in the first two phases, i.e., 1995 and 1998, there has been little actual liberalization and the requirement has been satisfied. Further, very little liberalization will happen before 2002. Moreover the agreement

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24 Ibid., pp.54-56.

also does not take up as to how much in each garment category will be liberalized. These issues are also likely to figure prominently in future trade talks.

(iii) *Anti-Dumping*:

Dumping is the exporting of a product at less than its normal price. It is illegal under WTO provisions. For anti-dumping duties to be imposed, there must be a causal link between injury and the act of dumping. In certain *de minimus* or minimum thresholds, anti-dumping investigations will not be started, e.g., if the margin of dumping is less than 2%. The minimum thresholds are the same for developed and developing countries. Indians face the problem that if normal value is calculated on the cost of production, the exporters are not able to furnish book accounts separated into domestic and export sales. Non-transparent indirect tax structure also causes problems.

In future trade negotiations, India is likely to argue that under special and differential treatment, the *de minimus* threshold for India should be raised. Loopholes in defining normal value should also be plugged. Anti-subsidy and anti-dumping investigations should also not be directed against the same products nor should there be back to back dumping investigations, as in the case of unbleached cotton fabric that India exported to EU. There should be compensation for the developing country, if dumping is not proved in an investigation. These principles could guide India's arguments against the EU in future.

(iv) *Competition Policy*:

Till now, India has been arguing that, it does not want to discuss competition policy in the trade talks. But in future this should be made one of the agenda items. While most distortions in the developing countries are state-induced like government procurement, most distortions in developed countries are private sector induced. These distortions should be targeted especially those of the EU. The time taken to frame policies on the issue on a global basis would range from one to two years. This will give enough time for India to frame its own competition policy. So future talks with EU should take this issue up.

(v) *Government Procurement and Services*:

The agreement on government procurement is a plurilateral one. The original version goes back to the Tokyo Round and covered only goods and national level procurement beyond a threshold. Uruguay Round extends the issue to a subnational level. With purchase preference and price preference eliminated, India should be comfortable with the Tokyo version.

During the Uruguay Round Negotiations, the issue of trade in services was discussed outside the system. Some agreements are multilaterally discussed, while others are bilaterally discussed ones. The major issue that will crop up between India, and EU is the issue of allowing cross border movement of skilled personnel for temporary periods of time.

(vi) *The issue of Electronic Commerce*:

In this field, there are constraints in the form of the absence of Electronic Data Interchanges (EDI) and the lack of computerization in Less Developed Countries.[25] It is likely that, in future India would argue that negotiations on this should be done through the World Customs Organization (WCO), with no stipulated deadlines for harmonization or computerization. India should negotiate with the EU and USA to create a tax-free cyberspace regime, to exploit its potentialities fully in the field of Information Technology.

(vii) *Environment and Labour*:

The current crop of Euro-protectionist measures are based on environment and labour-related standards. But there is a consensus among the developing countries that any attempt to bring the two through the backdoor into trade have to be clearly resisted. India will call for shifting labour related issues to the International Labour Organization (ILO). It will also argue that there are no further need for any new agreement on environment. India could also cite the sanitary and phytosanitary measures as examples of Non-Tariff Barriers.

CONCLUSION

EU is India's largest trading partner. It is also the biggest investor in India and the provider of the largest development assistance to India. Both entities have a lot

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25 Ibid.

in common like the existence of strong democratic traditions, liberal secular ethos and even cultural values like mutual co-existence. With the emergence of the EMU, Europe has started gaining considerable supranational prominence. Very, soon Europe could emerge as the world's most dominant power centre.

In recent times, trade relations between India and Europe have turned for the better. Five new measures were proposed to expand the scope of dialogue between the two entities. They encompass ministerial meetings, followed six months later by senior officials meeting, creation of adhoc working group of experts on issues of mutual interest, increased EU-India discussions on the margins of multilateral fora, meeting between EU policy planners and Indian External Affairs ministry.

India has been viewing EU as the single largest potential market, while the share of EU in India's imports is also massive. EU accounts for 25% of India's exports while India imports 30% of its global imports from EU.[26] EU is the largest single potential market because it houses 370 million people with a high purchasing power. India exported $9,145.90 millions worth of items in 1997-98 and $9,059 millions worth in 1998-99. ON the other hand its imports were $10,680.50 million and $10,340.60 million in 1997-98 and 1998-99 respectively.[27]

The EU's trade policy with India is seen as one which is tarred with a spate of non-tariff obstacles like health, sanitary and phytosanitary standards, rigorous

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26 Srinivas, G., "What is EU Agenda *vis-a-vis* India?", *Business Line* (Delhi), 6 March 2000.

27 Ibid.

packaging, and labelling requirements, preferential trading arrangements, a complex system of quota and tariffs, insistence by the EU private sector on voluntary code of conduct for ensuring better environmental standards and actions and repeat actions like anti-dumping and anti-subsidy probes against Indian products, including cotton, textiles, steel, drugs, etc.

There is also a clear difference in perception between the Northern states such as U.K., Germany, Benelux, and Nordic countries and southern economies like Italy, Spain, Portugal, Greece etc. The former group generally supports liberal trade policies while the latter tend to favour harsher trade defence actions.

Finally, it would be worth noting that, the trade obstacles between India and European Union are far too many to be wished away. But these problems are of such a nature that only a co-operative effort between the two entities shall provide lasting solutions.

CONCLUSION

The study on European Protectionism has not only revealed the protectionist nature of European trade policies, but also the fact that the WTO is slowly becoming an instrument for pursuing such policies.

It may be seen that some of the provisions which were meant to help the developing Countries (and hence included in the WTO Charter) are now being interpreted and used against them. For example, the provision on Balance of Payment (BOP) states that countries having BOP constraints may maintain physical restriction in the period of difficulty. Otherwise, countries are supposed to remove such restrictions within a specified time schedule. Paragraphs of the "Understanding on the Balance of Payment Provisions" requires a member state to announce publicly the time schedule for the elimination of restrictive imports. The said time schedule shall be changed as appropriate to take into account changes in the BOP situation. This statement has been cited by developed countries, including the EU, to ensure faster elimination of Quantitative Restrictions (QR).

The WTO also promises many special and differential treatment measures for the Less Developed Countries. They include:

(a) Longer transition period with regard to obligations.

(b) Favourable thresholds with respect to application of certain measures, e.g., anti-dumping, countervailing measures etc.

(c) Clauses providing for specific action by developed countries with respect to certain agreements, e.g., Sanitary and Phytosanitary Measures (SPS), Technical Barriers to Trade (TBT), etc.

With regard to the longer transition period, it may be noted that, the scheme entails just a postponement of the obligation to liberalize. Most of the developing countries have yet to undertake policy and legal adjustments with respect to various agreements. They would be found defaulting on many of the obligations when the transition period ends on 1 January 2005.

The concept of favourable thresholds also deal with the 'deminimise' provisions in the agreements on anti-dumping and subsidies and countervailing measures. The thresholds suggested are too low and hence have been of hardly any help to developing countries.

The clauses providing for specific actions by developed countries for developing countries as given in the SPS and TBT agreements are a facade. Firstly, these provisions do not ensure time bound commitment. Secondly, there is no mechanism to ensure that such actions are taken with due commitment. As a result, many of the provisions remain mere dead letters. The following provisions have been observed more in their breach, than in their implementation:

(a) Article 9, which calls for technical assistance to members especially for the developing world,

(b) Article 10, which calls forth special and differential treatment and longer time frame for compliance for developing countries,

(c) Article 11, which provides for technical assistance for Less Developed Countries,

(d) Article 12(7), which states explicitly that the preparation and application of technical regulations, standards and conformity assessment procedures do not create unnecessary obstacles to expansion and diversification of exports from developing country members.

Though, once again, the agreements on SPS and TBT, provide for technical assistance, they do not mean much in terms of actual transfer of technology. However, the fact remains that without effective transfer of technology to developing countries to meet the Western market entry standards, market access will always remain a problematic area. The WTO does not create any binding obligation in this regard too. Barring the issue of compulsory licensing, agreement on Trade Related Intellectual Property Rights (TRIPs) is also silent on this point.

The WTO text may also be noted for the vagueness of terminology of its provisions when dealing with special treatment for developing countries. Nowhere is it better seen than in the case of anti-dumping measures. The agreement uses vague terms, like 'special regard', 'special situation', 'constructive remedies', 'essential interests' etc., with the result that no binding obligations are placed on the developed countries.

Finally, it may also be noted that the real effectiveness of WTO with regard to issues relating to market access is far from satisfactory. In spite of tariff reduction by developed countries, the developing countries face stiff tariff barriers. This is because developed countries, especially the EU, maintain high levels of tariffs on products of interest to developing countries, particularly on textiles. All these facts have unfortunately meant that the WTO instruments have played into the hands of the developed world.

As regards the credo of protectionism in Europe, it must be noted that the origin of the concept dates back into history. Many would locate the first instances of protectionism in the Roman empire's efforts to prevent the loss of through trade to India or, more recently, in the Corn Laws which were introduced in England. But a systematic and well planned effort at building an institutional mechanism to protect domestic industries from foreign imports can be traced back only to the Zollverein. It would in fact be appropriate to say that the Zollverein, for the first time, unified many divergent domestic markets into one cohesive unit of internally transparent, but externally opaque, markets. It also highlighted the immense potentialities of such an effort. The Zollverein was successful in raising both the consumer as well as the producer surpluses of all the participating economies, while, at the same time, preventing low cost international producers from posing a challenge to domestic producers.

Europeans are not the ones to part with tradition. They found traditional protectionist concepts making a deep impact on their modern trade policies as well. Protectionism got deeply entrenched in European trade law in the form of countervailing measures, anti-dumping measures, anti-subsidy measures, sanitary and phytosanitary measures, Common Agricultural Policy (CAP) etc. The tenacity of European protectionism is most clearly illustrated in the way they dealt with the issue of agriculture, even when they were forced to liberalize as a result of the Blair House Accord. They denoted 1986 as the base year for reductions because this was an year of bumper harvests throughout Europe and reductions from this would have meant that what remained after reductions were themselves of a high value. Again in the

case of MFA agreement too, for many countries, like India, 30-35% of textile exports are already outside quotas. So the first two instances of quota liberalization, i.e., in 1995 worth 16% and 1998 worth 17%, have not created any new binding obligations on the European Union.

Many of the European protectionist measures have a garb of ethics shrouding their real nature and intent. For instance 'eco-labelling' has as its stated purpose not only the adoption of a high environmental standard for production and packaging, but also the continuous quest for higher standards. But the real effect of the scheme on foreign producers will be that, they will have to constantly update their production technique. They will be denied the advantage of producing according to set production patterns. Another example for a discriminatory provisions is the one regarding Electronic Commerce. Europe is finding itself in a distinctly disadvantageous position with regard to software professionals. But instead of letting developing countries, like India to take advantage of the situation, it has decided to adapt the existing Value Added Taxes (VAT) to Electronic Commerce. Moreover this VAT would be levied on foreign companies on the basis of the consumption point of the service rather than the standard European practice of levying the tax on the supply point. All this, in spite of the global consensus that Electronic Commerce should not be taxed.

The most important instrument of Euro-protectionism today is that of Environment related trade clauses. The SPS and TBT measures have necessitated drastic production changes in the production processes of other countries especially those of Third World producers. A few major points need to be noted here. When we

talk of environmental and other standards, we have also to look at the differential assimilative capacities of different countries. The Third World nations have a lower assimilative capacity with regard to cutting edge standards of environment protection. So, quickly raising the standards stipulated for imports would only result in providing encouragement to domestic producers in the European Union and, to some extent, other Western nations who are in touch with the requirements of the new technology and who have much greater assimilative capacity too. Again, the development of new technologies for production in an environmentally sound way requires huge investments in Research and Development (R&D), which most Third World nations are unable to make. Further, as theories of development indicate, investment, to a considerable extent, determined by the size of the domestic market, in which the producers attain economies of scale, perfect the product, and later on they export. But in many of the developing countries, the market for environmentally friendly products is very limited. It takes time for the domestic markets to absorb environment friendly values.

India and the European Union share a highly asymmetrical trade relation. Indian exports and imports constitute a minuscule proportion of European Union's overall trade while trade with European Union constitutes the largest single chunk of India's trade with the outside world. This, in fact, is the basic difference which is reflected in the differential bargaining power between the two entities. Initially, the phoney 'the Generalised System of Preferences' (GSP) was extended to India. But, this scheme was made practically irrelevant due to the negation of benefits to 'sensitive' products and 'graduated' products. Moreover India too has not been spared

from the use of protectionist tools. A wide variety of commodities, ranging from dyes, cheaper steel, garments etc., have been saddled with discriminatory duties. The recent imposition of anti-dumping duty on Indian steel is a case in point. The differences between the two have been brought to the fore in the various rounds of trade talks and especially at Seattle. The round of negotiations itself collapsed due to the efforts of advanced countries to link environment and labour to trade. In spite of all these, there seems to be a realization among the two sides that for mutual benefit and future prosperity, cooperation rather than conflict should be encouraged.

Why is there protectionism in Europe?

The popular arguments for European protectionism are couched in terms of national interest. They do not admit that their primary concern may be with sectoral interests. An important example is the pauper labour argument which seeks to serve labour interests by preventing imports from low wage countries.

Another reason why europeans resort to protectionism is that, they are hardly impressed by the Pareto-efficiency arguments for free trade. The Pareto criterion only states that, if gainers fully compensated losers, a net gain to the initial gainers would remain from a movement of free-trade. Since such redistribution does not take place normally there are bound to be losers which Europeans hardly prefer.

Another reason why Europeans prefer protectionist policies is to off-set the domestic market distortions. European markets, especially in the case of agriculture, are highly distorted by the provision of specific subsidies etc. Trade intervention can specifically be of help in the case of market imperfections if non-trade policy interventions result in higher costs than protectionist measures.

Again there is also the terms of trade argument for tariffs or export taxes. It is an argument that Western Europe may be able to improve its welfare at the expense of other nations through a favourable tilt in of trade brought about through protection.

Finally, the major reason why the EC adopted protectionist measures was that, after the Second World War, and even recently, it has found itself lagging behind other developed countries in terms of aggregate output, labour productivity and in other basic economic indicators. So it saw protectionism as a way out of this muddle.

Consequences of Euro-Protectionism

Euro-protectionism has had wide ranging as well as undesirable consequences on the world economy.

(1) The unfair protection given to European agriculture has distorted the world market prices for agricultural products. It has created a situation where the traditional comparative advantage theory has been nullified. West Europe has been an area which has a traditional disadvantage in agriculture. But due to the Common Agricultural Policy (CAP), it has cornered a share of the world market, which is not legitimately its own. Moreover, the surplus European products render the world market prices unstable (because, the world market is residual to CAP) and there is no long term basis for making structural adjustments for developing countries to take into account EU's artificial position as an agricultural exporter.[28]

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28 Vincent Cable, "The Causes of Protection: From Economic to Historical Determinism?", in Herbert Giersch, *Free Trade in the World Economy* (Tubingen: Institut fur weltwirtschaft an der universitat, Kiel, 1987), p.311-12.

(2) There is the loss of net national income from reduced export volumes (here export earnings have to be deflated to allow for non-domestic inputs and opportunity cost of scarce facts. It is only in a pure 'vent for surplus' situation that the loss of export volume would represent an approximation to net national income loss. For e.g., it is true for Indian garments made from handloom, but not for fully employed economies).

(3) European Protectionism makes the ideal of wage-price equalization, envisaged by Heckscher-Ohlin and Stopler Samuelson, impossible of attainment. The only hope for the attainment of this objective is free trade without barriers between developed and developing countries.

(4) There is also the terms-of-trade effect. Protection in a large importing economy turns the terms of trade against the exporter. This is clearly visible in the case of EEC agriculture where the domestic supply response to protection has been such as to crete large exportable surpluses, which depress world markets.

(5) By protecting industries which are capable of high value addition while leaving the market for relatively lower end products open, the EU is preventing the specialization of developing countries in high value added products.

(6) There are efficiency losses of various kinds. Resource misallocation results from enforced departures from the most efficient production patterns dictated by comparative advantage. There can be losses of economies of scale. There can be efficiency losses as trade is diverted from one exporter to a higher cost exporter. It

can also lead to various effects, encompassed by the concept of X-efficiency, e.g., the encouragement which voluntary export restraints give to rent seeking behaviour and cartelization.[29]

(7) Any exercise in protectionism which has substantial impact on aggregate trade flows will generate trade imbalances, which in turn may necessitate a Balance of Payment Adjustment through exchange rate or other mechanisms. The impact of European export subsidies and import restrictions have been to raise the exchange rate.

(8) It may lead to losses from discouraged investments in developing countries. This is true of footloose foreign investment which may be discouraged due to loss of growth opportunities and general uncertainty.

(9) It may, in the long run, force developing economies to adopt inward oriented, anti-export policies, thereby hindering the process of global trade liberalization.

(10) The wide ranging environmental regulations of the EU have caused substantial dislocation in the production pattern of developing countries and has also made the exports of small producers unviable due to the high transition cost.

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29 Ibid.

Suggestions

A few suggestions can be deemed appropriate to soften the pressure of protectionism emanating from the European Union. Since the European Union often manipulates the rules of the WTO to achieve its protectionist ends, a simultaneous reform of WTO rules should also be deemed as necessary.

(a) A major source of trade distortion between EU and India is due to the asymmetrical nature of trade relations which exists. All efforts should be made to change this. Market penetration is more a result of superior quality of one's products, competitive prices, punctuality in adhering to one's delivery schedules, etc. Indian exporters have been found wanting on many of these counts. Internal market competitiveness through internal liberalization can go a long way in achieving this. Unless the Indian government moots policies to improve the market penetrativeness of Indian products, the bogey of trade protectionism (though true), alone may not be enough to justify the poor performance of Indian exports in the European Markets.

(b) Very often European Union has been found, more to follow the letter of trade laws than their spirit. For e.g., much debate has taken place in the European press with regard to the banning of Indian carpets produced from child labour. Though the intention behind the laws regarding labour clauses are laudable, the fact remains that the sudden imposition of such a ban, without any regard to the structural adjustments required in the industry, would make millions of people unemployed. So it is apt to suggest that before the unilateral imposition of such measures, a

consultative committee should be set up with the offending party and adequate time should be given for structural adjustments to take place.

(c) The countries which face trade discrimination from the European Union in future should make it a point to activate, repeatedly, the Committee on Market Access, to examine the existing and emerging barriers to market access.

(d) In order to prevent the future use of protectionist tactics by the European Union in all future trade agreements the contracting partner should make it a point to lay down clearly binding market access commitments on the part of the European Union.

(e) Agreements on SPS and TBT should clearly bind the EU with specific commitments and also with the responsibility to publicly announce the actions taken by them.

(f) The developing countries should reach an agreement with EU and others, for extending the transition period with respect to the application of TRIMs Agreement.

(g) The De-Minimise provisions in the agreements on anti-dumping should be substantially enhanced for developing countries.

(h) The issue of the misuse of anti-dumping provisions should be taken up with EU and an agreement should be reached among all the parties for a substantial overhauling of the said provisions.

(i) Efforts should be made to create a consensus among all the nations to prevent the misuse of actionable subsidy clause by the European Union. The Union has been continually ignoring the fact that exporters entail local costs while producing for exporting.

(j) The EU must be made to give a commitment to reduce peak tariffs on major items of exports from the developing countries. This would go a long way in checking trade distortion.

(k) In order to make the transition to an appropriate level of technology needed for exporting to EU, agreements must be clearly appended to TBT, SPS, TRIMs, etc., to elicit smooth transfer of technology from the developed world to the developing countries. The commitment in this regard should be specific and unambiguous.

(l) The European Union should also try to use more and more of market premiums and preferential market access for ecologically friendly products rather than "green countervailing duties" on products produced under laxer environmental standards.

(m) The WTO itself should ensure greater participation of all countries, particularly the developing countries in the International Organization for Standards (ISO).

(n) In the field of environment, at the International Level, the WTO should ensure proportionality by weighing the economic costs of environmental measures on

other country exports against the Environmental benefit for EU, which has imposed these, taking into account cost, timing of implementation, necessity and effectiveness.

(o) The provisions of the WTO regarding preferential treatment of developing countries should be amended to allow states to discriminate in favour of developing countries when taking environmental measures.

(p) The provisions of GATT should be amended to allow states to discriminate in favour of developing countries whose exports have a small market for products of certain standard specification.

(q) Regarding the focus of Indian exports, it should be noted that it is concentrated in a few EU countries. It would be better for India, now to give adequate attention to other European countries, which too have big markets, and

(r) Both at the time of negotiations and also at the time of Indian policy making, efforts should be made to get sufficient inputs from Economists and political economists.

"There is so much to do,
There is no time for feeling blue,
There is no point in feeling bad,
Things could be worse,
Right now they are only bad"

- Vikram Seth in the *Golden Gate*

APPENDIX

EUROPEAN UNION'S INSTITUTIONAL FRAMEWORK

(a) *The Commission*:

The Commission consists of 20 members appointed by the member states to serve for four years. Austria, Finland, Greece, Belgium, Denmark, Ireland, Portugal, Sweden, Netherlands and Luxembourg -- all have one Commissioner each whereas France, Germany, Italy, Spain and U.K. have two members each.[30] The Commission acts independently in the interest of the Community as a whole. Its mandate is to implement the treaties. It has the right to initiative i.e., putting the proposals of the Council into action and their execution once the Council has decided upon it.

(b) *The Council of the European Union*:

It consists of ministers from 15 national governments and represents national as opposed to community interests. It is the body which has the power of decision making in the Community. The distribution of membership is as given below.[31]

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30 Chris Cook, and John Paxton, n.1, p.20.

31 Ibid., p.21.

Sl. No.	States	Members	Sl. No.	States	Members	Sl. No.	States	Members
1.	Austria	4	7.	Greece	5	13.	Spain	8
2.	Belgium	5	8.	Ireland	3	14.	Sweden	4
3.	Denmark	3	9.	Italy	10	15.	U.K.	10
4.	Finland	3	10.	Luxembourg	2			
5.	France	10	11.	Netherlands	5			
6.	Germany	10	12.	Portugal	5			

The qualified majority is 62. Simple majority is 44 and a blocking majority is 26. The presidency of the Council rotates every 6 months.

(c) *European Parliament*:

It consists of 626 members elected by member states[32] as given below:

Sl. No.	State	Members	Sl. No.	States	Members
1.	Austria	21	8.	Ireland	15
2.	Belgium	25	9.	Italy	87
3.	Denmark	16	10.	Luxembourg	6
4.	Finland	16	11.	Netherlands	31
5.	France	87	12.	Portugal	25
6.	Germany	99	13.	Spain	64
7.	Greece	25	14.	Sweden	22
			15.	U.K.	87

The Parliament has the right to be consulted on a wide range of legislative proposals and forms the arm of the Community budgetary authority.

32 Ibid., p.22.

3. *The European Court of Justice*:

It is composed of 13 judges and 3 Advocate Generals. It is responsible for the adjudication of disputes arising out of the application of treaties and its findings are enforceable in all member states.

(4) *Economic And Social Council*:

It has an advisory role and consists of 189 representatives of employees, trade unions, consumers etc.

(5) *The Court of Auditors*:

It was established in 1975. It consists of 12 members and was raised to the status of a full EU institution by the Maastricht Treaty of 1993. It audits all income and the current and past accounts of the EU.

(6) *The European Investment Bank*:

It was created in 1958. Its governing body, i.e., the Board of Governors consists of Ministers designated by the member states. Its task is to ensure balanced development of the Common Market in the interest of the Community by financing projects for the development of less developed regions of the community.

(g) *The European Monetary Institute*:

It is based in Frankfurt and was established by the Maastricht treaty. It has become defunct with the establishment of the European Central Bank, which now administers the single currency.

The Schengen Agreement:

It was signed in 1990 by France, Federal Republic of Germany, Belgium, Luxembourg and Netherlands. The agreement committed the member countries to abolishing internal border controls. Later Spain and Portugal also became its part. In May 1995, the removal of passports, customs and immigration controls came into force. Austria joined the scheme in 1995 and Italy and Greece in 1996.[33] The Schengen Agreement became the major factor which pushed West Europe towards a Union.

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33 Chris Cook, and John Paxton, n.1, p.22.

The Montreal Protocol

In the 1970s, scientists hypothesized that chemical gases released by human activity might deplete stratospheric ozone, which protects the Earth's surface from damaging ultraviolet radiation emanating from outer space. By the 1980s accumulated evidence pointed to the fact that this, in fact, was happening. Following the early lead of the United States, Canada, Sweden and Norway, the world's major producers and consumers of the substances causing the problem agreed in the 1985 to cooperate in protecting the ozone layer pursuant to the framework Vienna Convention for the Protection of the Ozone Layer. The Convention itself set no substantive limits, but the Montreal Protocol on Substances that Deplete the Ozone Layer, concluded in 1987, sets production and consumption limits for the principal ozone-depleting substances, chlorofluorocarbons (CFCs) and certain halons (Article 2).

The Montreal Protocol does not prohibit trade among Parties to the Protocol, who should anyhow be complying with the phase-outs, but it does prohibit trade in controlled substances and in products incorporating them with non-Parties that do not observe the Protocol's production and consumption limits (Article 4.2 & 4.3). If feasible, Parties may be required in the future to ban trade with non-observing non-Parties in products made with such substances, as well (Article 4.4). In addition, Parties must discourage the transfer to non-observing non-Parties of technology for producing and using the substances (Article 4.5).

The Protocol was adjusted and amended in 1990 to add several further compounds to the list of substances to be phased out, accelerate phasing them out of production and consumption, and establish a Multilateral Fund to provide financial and technical assistance to countries adopting ozone-friendly technologies. In 1991, the Multilateral Fund was increased and an Implementation Committee to address non-compliance issues was established. If a Party fails to comply with requirements of the Protocol, the Committee may recommend any of a series of measures ranging from assistance to suspension of rights and privileges under the Convention and Protocol, including trade restrictions (see Report of the Fourth Meeting of the Parties to the Montreal Protocol, Annex V (25 Nov. 1992)).

Source: "The Trade and Environment Agenda: Survey of Major Issues and Proposals".

The Danish Bottles Case

In the 1988 *Danish Bottles Case*, the European Court of Justice considered a challenge to Danish regulations that required both domestic and foreign suppliers of beer and soft drinks to use returnable and recyclable containers in shapes approved by the Danish National Agency for the Protection of the Environment. The regulations effectively required the use of glass containers. Importers complained that the regulations disproportionately burdened them because glass containers weighed more and, hence, cost more to transport, than other materials; higher transportation costs meant that compliance with the take-back obligation cost importers more; and being forced to use approved shapes hindered importers' ability to use distinctive bottle designs in competing with domestic suppliers. Denmark modified the law to exempt suppliers of less than 3,000 hectolitres per year from the shape-authorization requirements. Unsatisfied, the European Commission sued Denmark before the European Court of Justice for a declaration that the regulations constituted a measure having an effect equivalent to that of a quantitative restriction, in violation of Article 30 of the Treaty of Rome establishing the European Economic Community.

The Judge Advocate General, an official associated with the Court to provide it with an unbiased legal analysis and recommendation, agreed that Denmark's objective to preserve its environment by reducing the amount of waste to be disposed of in the country could justify the regulations in principle. In practice, however, both the take-back and the shape-authorization requirements were disproportionate to the burdens they caused on trade and should be declared a violation.

The European Court of Justice agreed only partially. It found that protection of the environment could be an adequate justification not only in principle, but also in fact for the mandatory take-back obligations. Of special significance was the Court's ruling that environmental protection was a mandatory objective of the Community, even in the absence of express language to this effect in the Treaty of Rome at the time. Accordingly, the Court concluded that the mandatory take-back obligations were a necessary element of the system and hence necessary to achieve the environmental aims being pursued. The Court agreed with the Advocate General, however, that the added burden of requiring approval of container shapes was disproportionate to any environmental harms that might be caused by allowing an unlimited number of containers to be used, since these would still be required to be returnable and recyclable. The Court concluded that the take-back obligation did not violate the Treaty of Rome, but the ban on sales without official authorization of the container did violate the Treaty.

The *Danish Bottles Case* stands as a recognition that environmental objectives may justify burdening trade, but the trade restrictions must be proportionate to the environmental aims.

Source: "The Trade and Environment Agenda: Survey of Major Issues and Proposals".

The S&PS Agreement

The Agreement on the Application of Sanitary and Phytosanitary Measures (S&PS Agreement) provides disciplines for Members imposing sanitary and phytosanitary (S&PS) measures that might affect international trade. In broad terms, sanitary and phytosanitary measures are those taken to protect human, animal or plant life or health from risks arising from the entry or spread of pests and diseases, or from contaminants in foods, beverages or feedstuffs (see Annex A.1). They include a wide variety of requirements including those regarding characteristics of products and processes or production methods (PPMs) related to the end product (see *id.*). The S&PS Agreement is similar to the TBT Agreement in certain respects (see Box 10: The TBT Agreement), but generally imposes stricter requirements, in part because it does not contain the usual GATT MFN or national treatment disciplines.

Like the TBT Agreement, the S&PS Agreement favours international standards. It requires WTO members to base S&PS measures "on international standards, guidelines or recommendations, where they exist, except as otherwise provided in this Agreement" (Article 3.1). Measures conforming to such international standards are "presumed to be consistent with the relevant provisions of this Agreement and of GATT 1994" (Article 3.2). Unlike the TBT Agreement, which leaves open the source of international standards to be followed, Annex A to the S&PS Agreement specifies the Codex Alimentarius Commission as the international source relating to food, the International Office of Epizootics relating to animals, and the International Plant Protection Convention relating to plants.

Pursuant to Article 3.3 members may introduce S&PS measures more stringent than international standards "if there is a scientific justification, or as a consequence of the level of sanitary or phytosanitary protection a Member determines to be appropriate" pursuant to procedures to assess risks (Article 3.3). In assessing risks, WTO members must take several specified factors into account, including "available scientific evidence" (Article 5.2) and certain economic factors (Article 5.3). In setting the appropriate level of safety, they must take into account the "objective of minimizing negative trade effects" (Article 5.4) and must "avoid arbitrary or unjustified distinctions in the levels [they consider] to be appropriate in different situations, if such distinctions result in discrimination or a disguised restriction on international trade" (Article 5.5).

Substantively, S&PS measures must be (1) "applied only to the extent necessary to protect human, animal or plant life or health", (2) "based on scientific principles", (3) "not maintained without sufficient scientific evidence" and (4) "not more trade-restrictive than required to achieve their appropriate level of sanitary or phytosanitary protection, taking into account technical and economic feasibility" (Articles 2.2, 5.6). A footnote clarifies that the fourth requirement is met "unless there is another measure, reasonably available taking into account technical and economic feasibility, that achieves the appropriate level of sanitary and phytosanitary protection and is significantly less restrictive of trade" (Article 5.6 n.3). If relevant scientific evidence is "insufficient", members may take provisional measures based on whatever scientific evidence is available, but must seek further information and review the measures within a reasonable period of time (Article 5.7). They must also accept the S&PS measures of other members as equivalent, even if different, so long as the exporting member "objectively demonstrates" to the importing member that its measures achieve the importing member's appropriate level of S&PS protection (Article 4.1).

Annex B to the S&PS Agreement establishes transparency requirements pursuant to which WTO members must provide interested parties "notice at an early stage" of proposed S&PS measures, as well as an opportunity to comment on them. WTO members must promptly publish final S&PS measures and establish an "enquiry point" to supply relevant documents and answer reasonable inquiries from interested WTO members.

A Committee on Sanitary and Phytosanitary Measures acts as a forum for consultations on S&PS issues, as well as to foster the international harmonization of S&PS standards (Article 12). Provision is made for technical assistance and special treatment for developing countries (Articles 9-10), including delays in implementation of 5 years for least developed countries and 2 years for other developing countries (Article 14).

Like the TBT Agreement, the S&PS Agreement applies directly only to measures of central governments, but obliges central governments to take "such reasonable measures" to ensure that non-governmental and regional bodies follow the same disciplines (Article 13).

Source: "The Trade and Environment Agenda: Survey of Major Issues and Proposals"

Sor

The Convention on Biological Diversity

The three objectives of the Convention on Biological Diversity are the conservation of biological diversity, the sustainable use of biological resources, and the fair and equitable sharing of the benefits arising from the use of genetic resources (Article 1). The Convention obliges members to take various steps to conserve biodiversity within their jurisdictions, emphasizing in situ conservation and the role of traditional lifestyles and local communities (see Article 8.) The Convention recognizes the sovereign right of States to control access to their genetic resources, but obliges Parties to endeavour to create conditions to facilitate access to those resources for environmentally sound uses, on mutually agreed terms and subject to prior informed consent of the Party providing the resources (see Article 15). In return, Parties providing such access may participate in the scientific and biotechnological research and in any negotiated benefits based on the resources provided (see Articles 15.6, 15.7, 19.1 & 19.2). The Convention also includes provisions requiring Parties to facilitate access to and transfer of technology and biotechnology to developing countries (Article 16). Such access and transfer must be on terms recognizing and consistent with the adequate and effective protection of IPRs (Article 16.2).

Source: "The Trade and Envionrment Agenda: Survey of Major Issues and Proposals".

The TBT Agreement

The Agreement on Technical Barriers to Trade (TBT Agreement) concluded in the Uruguay Round provides disciplines regarding the setting and enforcement of technical standards to reduce associated burdens on international trade. Specifically, the TBT Agreement applies to any "document" that sets mandatory standards (referred to as "technical regulations") or voluntary standards (referred to simply as "standards") for products. Separate Agreements cover technical standards relating to government procurement and to sanitary and phytosanitary measures. Unlike its predecessor, the TBT Agreement covers not only standards for characteristics of products themselves, but also standards for "related processes and production methods" (see Annex 1, ¶¶ 1 & 2). It is not yet clear precisely what standards based on PPMs are covered and what not, but many believe that the Agreement is intended to cover only PPMs that are reflected in the product itself. Thus, for instance, laws requiring the incorporation of recycled materials in a final product may be covered, but laws banning the importation of hardwood products derived from unsustainably managed tropical forests may not.

The TBT Agreement attempts to foster the harmonization of technical regulations and standards by favouring the use of international standards. Whenever a member has adopted or expects to adopt technical regulations for a product, it is required to participate, within the limits of its resources, in efforts to set international standards for that product (Article 2.6). If "relevant international standards" exist, then WTO members must use them as the basis for their technical regulations, unless the international standards would be "ineffective or inappropriate means for the fulfilment of the legitimate objectives pursued" in establishing the standards (Article 2.4). Protection of human health or safety, animal plant life or health or the environment constitutes an objective explicitly recognized as legitimate (see Article 2.2). If members do impose a technical regulation for a legitimate objective and based on available international standards, then the technical regulation is "rebuttably presumed not to create an unnecessary obstacle to international trade" (Article 2.5). Similar requirements apply to any procedures to assess conformity with either technical regulations or standards (see Articles 5.4-5.6).

If international standards are not followed, the TBT Agreement imposes both procedural and substantive requirements. When proposing technical regulations or conformity assessment procedures not based on international standards, members must provide prior notice and opportunity to comment "at an early appropriate stage, when amendments can still be introduced and comments taken into account" (see Articles 2.9 & 5.6). Members must also publish final technical regulations and any conformity assessment procedures promptly (see Articles 2.11 & 5.8) and must establish "enquiry points" to which other Members and interested parties may turn for information (see Article 10). Substantively, technical regulations and conformity assessment procedures must obey the existing GATT obligations regarding national and most-favoured nation treatment (see Articles 2.1 & 5.1). In addition, the TBT Agreement imposes a new rule known as the "least trade restrictive" test: Technical regulations "shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create" (Article 2.2). Conformity assessment procedures must meet a similar test (see Article 5.1.2) and, whenever possible, governments must accept the results of equivalent procedures in other members, even if different (see Article 6).

The disciplines of the TBT Agreement apply directly to central governments. They also form the basis for an annexed Code of Good Practice to which non-governmental bodies establishing standards may adhere. Central governments are required to take reasonable measures to ensure that other governmental entities and non-governmental standardizing bodies abide by similar rules (see Articles 3, 4, 8).

Source: "The Trade and Environment Agenda: Survey of Major Issues and Proposals".

The TRIPS Agreement

The Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights, commonly known as the TRIPS Agreement, extends the international trade regime to intellectual property rights (see Box 11: Intellectual Property Rights). More importantly, the Agreement obliges WTO members to provide at least a specified level of protection to all the generally recognized forms of IPRs, including copyrights (Articles 9-14), trademarks (Articles 15-21), geographical indications (Articles 22-24), industrial designs (Articles 25-26), layout designs for integrated circuits (Articles 35-38), and trade secrets (Article 39).

At the heart of the Agreement, however, are the provisions concerning patents (Articles 27-38). WTO members must give inventors exclusive rights to the use of their inventions for a minimum of twenty years from the date of filing the patent application (Articles 28 & 33). Patents must be available for inventions in "all fields of technology" if they are "new, involve an inventive step and are capable of industrial application" (Article 27.1). Members may, however, deny patents if "necessary to protect *ordre public* or morality, including to protect human, animal or plant life or health or to avoid serious prejudice to the environment" (Article 27.2). In a provision to be reviewed in 1999, members may also deny patents on "plants and animals other than micro-organisms, and essentially biological processes for the production of plants or animals", although they must protect plant varieties under either a patent or a *"sui generis"* system of protection (Article 27.2(b)). Under a general exception applicable to the entire Agreement, members may also adopt "measures necessary to protect public health and nutrition, and to promote the public interest in sectors of vital importance to their socio-economic and technological development, provided that such measures are consistent" with the Agreement (Article 8.1).

In provisions applicable to all covered forms of IPRs, the Agreement also specifies minimum general enforcement obligations (Article 41), civil and administrative procedures and remedies (Articles 42-49), provisional measures (Article 50), special requirements related to border measures (Articles 51-60) and criminal procedures (Article 61).

As a general matter, the main obligations of the TRIPS Agreement are delayed for all members until 1996, for developing countries until 2000 and for least developed countries until at least 2005 (Articles 65-66). Developing countries that would be required to extend patent protection to new technologies may delay that extension for an additional five years (Article 65.4). The TRIPS Agreement also requires developed country members to provide incentives to promote technology transfer to least developed countries (Article 66.2).

Source: "The Trade and Environment Agenda: Survey of Major Issues and Proposals".

The Tuna/Dolphin Disputes

The Tuna/Dolphin disputes concerned challenges to the application of the United States Marine Mammal Protection Act (MMPA), 16 U.S.C. § 1371(a), which barred the importation of tuna from the eastern tropical Pacific Ocean if caught using purse seine nets. The only exemption from the trade restriction would occur if the State whose fisherman caught the tuna had implemented policies to protect dolphins from being killed incidentally and, at the end of the season, the number of dolphins killed was no more than 1.25 times the number killed by U.S. fishermen during that season. The MMPA created two levels of import restrictions: a primary one against the State that had caught the tuna in question and a secondary one against third States that imported such tuna.

In *Tuna/Dolphin I* the dispute-panel considered Mexico's complaint about the law's application to its exports. It held that the ban on imports constituted a quantitative restriction prohibited by GATT Article XI. In addition, these measures could not be considered domestic legislation neutrally applied to domestic and foreign tuna (as required by GATT Article III), because it distinguished between the tuna on the basis of how the tuna was caught, as opposed to the tuna as such. This conclusion has since been summarized as holding that GATT forbids the regulation of trade based on processes and production methods (PPMs) rather than on the traded product itself. The panel went on to hold that the general exceptions clauses of Article XX(b) and (g) did not apply, because they cover only measures relating to animals and natural resources within the jurisdiction of the country taking the measures. The panel also noted that the trade ban could not be considered "necessary" within the meaning of Article XX(b), since the United States had not exhausted avenues to resolve the problem through international negotiations, suggesting that the GATT prefers actions taken pursuant to multilateral agreement.

Many observers, particularly those associated with environmental NGOs, greeted the reports, especially the one from *Tuna/Dolphin I* with dismay. In their eyes, the reports demonstrated that the GATT failed to take serious account of environmental problems. Worse, they feared that world trade rules could be used to unravel environmental successes already achieved.

In *Tuna/Dolphin II* the dispute-settlement panel considered complaints by the European Economic Community and The Netherlands about the MMPA's secondary embargo on products from third countries that imported barred tuna. Like the first, the second panel considered the law a prohibited quantitative restriction not covered by Article XX. Unlike the first panel, however, it did not limit that article's application to natural resources within the jurisdiction of the country taking the measure, but held that Article XX does not apply to measures that could only achieve their protection goals indirectly, by inducing other countries to change their policies.

Neither dispute-settlement panel report was adopted, preventing them from becoming strictly binding on the United States. They may, nonetheless, be looked to as unofficial, persuasive interpretations of the GATT. It has also been pointed out that most contracting Parties, other than the United States, agreed with the results.

Source: "The Trade and Environment Agenda: Survey of Major Issues and Proposals".

The Uruguay Round

In 1986 trade ministers began the latest round of trade negotiations pursuant to the GATT in Punta del Este, Uruguay. In addition to further reducing tariffs and non-tariff barriers to international trade, the negotiators sought to strengthen certain aspects of the trading regime (*e.g.* the mechanism for resolving disputes), expand the application of GATT principles into new areas (*e.g.* services), and create the World Trade Organization as a permanent international institution to implement the GATT and address new trade issues as they arise. The agreements reached during the Uruguay Round were collected into a single Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations. Once one becomes a member of the WTO, all the legal agreements forming part of the Uruguay Round package become binding. The agreements most relevant to environmental law and policy are:

- the General Agreement on Tariffs and Trade 1994 (GATT 1994), reaffirming the original GATT (GATT 1947), as amended by listed protocols, understandings and decisions;
- the Agreement Establishing the World Trade Organization [WTO Agreement];
- the Agreement on Technical Barriers to Trade [TBT Agreement], which provides disciplines for governmental and non-governmental standard-setting (see Box 8: The TBT Agreement);
- the Agreement on the Application of Sanitary and Phytosanitary Measures [S&PS Agreement], which provides disciplines for countries to follow in creating and implementing sanitary and phytosanitary measures (see Box 9: The S&PS Agreement);
- the Understanding on Rules and Procedures Governing the Settlement of Disputes [Dispute Settlement Understanding], which establishes a more judicialized dispute settlement mechanism;
- the General Agreement on Trade in Services [GATS]; and
- the Agreement on Trade-Related Aspects of Intellectual Property Rights.

Source: "The Trade and Environment Agenda: Survey of Major Issues and Proposals".

Intellectual Property Rights

Intellectual property rights (IPRs) are private legal rights concerning the intangible human contribution to new technology and other useful ideas. They allow private persons to control how their creative ideas are used commercially during the life of the IPR. In effect, the holder of an IPR has a monopoly on the use of the intellectual property and, therefore, of the technology embodying it. The holders of IPRs commonly grant permission for others to use the intellectual property pursuant to a licensing agreement in exchange for a licensing fee.

IPRs may take any of several forms. *Patents* are granted for any process, machine or composition of nature that is novel, useful and embodies an inventive or non-obvious step. The inventor is granted a private monopoly to exclude others from making, using or selling the invention for a fixed period, in exchange for publishing the subject matter of the patent. The Paris Convention for the Protection of Industrial Property, administered by the World Intellectual Property Organization, helps coordinate patent protection internationally, but until recently the kinds of inventions subject to patent protection and the extent of that protection were governed by national law, which varies from State to State. For instance, the United States has granted patents for living organisms, but many other States have not, because of moral and other questions of principle about extending patenting to life-forms. The TRIPS Agreement (see Box 12: The TRIPS Agreement) for the first time instituted international minimum standards of patent protection. These include extending patent protection to micro-organisms and non-biological and microbiological processes for the production of plants or animals. Patents have been issued for many technologies important to the environment, ranging from hardware and processes for preventing or cleaning up pollution, to pharmaceuticals based on biological materials, to agriculturally useful plants and chemicals.

An alternative to patents for seed varieties are *plant breeders' rights* (PBRs). PBRs are rights internationally recognized under the International Convention for the Protection of New Varieties of Plants (UPOV Convention) granted pursuant to national legislation for plant varieties that are new, distinct, uniform, and stable. Generally, PBRs allow their holders to exclude others from marketing or selling the protected variety. Unlike a patent, however, which forbids the unauthorized use of the patented product or process, a PBR does allow other breeders to use the protected variety to develop a new plant variety (the "breeders' privilege" exception).

Over time PBRs have been strengthened. In its 1978 version, the UPOV Convention covered only commercially marketing or selling the protected variety's propagating material. Farmers thus had the "privilege" to use seeds derived from a first crop to plant a second crop without paying the PBR owner a second royalty fee. The amended 1991 UPOV Convention, however, theoretically extinguishes the farmers' privilege by extending the PBR to all uses, although it does allow member States to limit PBRs in their national legislation. The amended Convention also forbids the use of a protected variety to create a new variety if the newly created varieties contains virtually all of the original variety's genes.

Another form of IPR is the protection of *trade secrets*. A trade secret is any information that the holder does not wish to publish for fear that a commercial competitor will be able to use it to the holder's disadvantage. Generally, trade secrets are protected by national laws against unfair competition and by private contractual obligations to maintain secrecy. Unlike a patent, trade secret protection does not prevent others from developing and using the information by, for instance, working backwards from finished products ("reverse engineering"). The Paris Convention links trade secret protection in Article 10bis to national laws on unfair competition, and the TRIPS Agreement requires members to allow private parties to protect their trade secrets (see Box 12: The TRIPS Agreement).

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